

**Anja Suknaič**

**European Union economic sanctions on Iran  
— Critical considerations**

**Universidade Fernando Pessoa**

**Porto, 2013**



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## **Resumo**

Esta dissertação centra a investigação sobre a questão de saber se as sanções económicas representam um instrumento eficaz no sentido de impedir o Irão de desenvolver actividades nucleares ilegais. O objectivo da pesquisa consiste igualmente em avaliar as consequências reais das sanções económicas para cada um dos Estados-Membros da União Europeia (UE), bem como outros Estados na cena internacional — sendo a eficácia das sanções avaliada com a ajuda de variáveis políticas e económicas.

A pesquisa inclui informações detalhadas sobre o perfil político do Irão, sobre as relações comerciais entre a UE e o Irão, sobre o programa nuclear iraniano e sobre as sanções impostas ao Irão. O trabalho extrai um certo número de resultados relevantes, onde se inclui o facto de que Irão tem o apoio de várias superpotências na cena internacional, e o facto segundo o qual os países da UE os mais envolvidos nas relações comerciais com o Irão são igualmente os mais afectados pela crise global internacional.

As principais conclusões a retirar do estudo apontam para a ideia de que as sanções contra o Irão foram até agora ineficazes, na medida em que a posse da arma nuclear é para o Irão mais prioritária do que a própria saúde económica do país. O estudo demonstra igualmente que as consequências das sanções para cada um dos Estados-Membros da UE provocam dificuldades acrescidas para encontrar novos parceiros comerciais. As sanções aplicadas teriam sido menos destrutivas se fossem impostas antes da crise económica global que afecta a maioria dos Estados-Membros da UE devido às dependências no comércio, e em particular a dependência das trocas com o Irão relativas ao petróleo.

**Palavras-chave:** União Europeia, Irão, Comércio internacional, Sanções económicas.

## **Abstract**

This dissertation focuses on investigating if economic sanctions represent an efficient tool that could manage to impair Iran's illegal nuclear activities, as well as on researching the real consequences that the economic sanctions bring for individual European Union (EU) members and other relevant countries on the international scene. The efficiency of sanctions has been evaluated with the help of certain political and economic variables.

The research includes detailed information on Iran's political background, on EU's trade relation with Iran, on Iran's nuclear program and on sanctions imposed on Iran. The research produces a number of key findings, including the fact that Iran enjoys the support of several influential superpowers on the international scene, and that EU countries most involved in trade with Iran are the ones most affected by the global economic crises.

The main conclusions drawn from this research are that the sanctions on Iran were so far not efficient, because Iran's possession of a nuclear weapon is more a priority to the country than its economic health. The research also shows that the consequences for individual EU members bring trouble in finding new trade partners, and would be less harmful if imposed before the global economic crises that most affects the EU members that are dependent on trade, and in particular oil trade, with Iran.

**Key words:** European Union, Iran, International Trade, Economic sanctions.

## Résumé

Ce mémoire aborde la question de savoir si les sanctions économiques représentent un instrument efficace pour empêcher l'Iran de développer des activités nucléaires illégales. L'étude vise également à évaluer les conséquences réelles des sanctions économiques pour chacun des États membres de l'Union européenne (UE), mais aussi pour d'autres États sur la scène internationale — l'efficacité des sanctions étant évaluée à l'aide de variables économiques et politiques.

La recherche comprend des informations détaillées sur le profil politique de l'Iran, sur les relations commerciales entre l'UE et l'Iran, sur le programme nucléaire iranien et sur les sanctions imposées à l'Iran. Le travail inspire d'un certain nombre de résultats pertinents, notamment le fait que l'Iran a le soutien de plusieurs grandes puissances sur la scène internationale et le fait que les pays de l'UE les plus impliqués dans le commerce avec l'Iran sont aussi ceux les plus touchés par la crise mondiale.

Les principales conclusions à tirer de l'étude soulignent l'idée que les sanctions contre l'Iran sont restées jusqu'ici sans effets majeurs, dans la mesure où la possession de l'arme nucléaires est pour l'Iran plus prioritaire que la santé économique du pays. L'étude montre aussi que les conséquences des sanctions pour chacun des États membres de l'UE conduisent à des difficultés accrues pour trouver de nouveaux partenaires commerciaux. Les sanctions appliquées auraient été moins nocives si elles avaient été imposées avant la crise économique qui touche la majorité des membres États membres de l'UE du fait de leur dépendance commerciale et en particulier de la dépendance relative au commerce du pétrole avec l'Iran.

**Mots-clés:** Union européenne, Iran, Commerce international, Sanctions économiques.

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## TABLE OF CONTENTS

<b>INTRODUCTION.....</b>	<b>1</b>
 <b>CHAPTER I. BACKGROUND CONCEPTS .....</b>	<b>7</b>
1. Types of economic sanctions.....	9
1.1. Sanctions as to their content .....	9
1.2. Unilateral and Multilateral.....	11
1.3. Negative and Positive .....	12
2. Embargo .....	14
3. Change in economic sanctions .....	15
4. Variables that affect sanctions .....	16
4.1. Political variables .....	16
4.2. Economic variables.....	18
 <b>CHAPTER II. IRAN POLITICAL AND ECONOMIC BACKGROUND.....</b>	<b>20</b>
1. Iranian political system.....	20
1.1. The Supreme Leader.....	21
1.2. The President .....	21
1.3. The Assembly of experts .....	22
1.4. The Expediency Council .....	22
1.5. The Guardian Council .....	22
1.6. The Islamic Consultative Assembly .....	23
1.7. The Supreme Court and the Council of the Judiciary .....	23



1.8. The Revolutionary Guard Corps.....	23
2. Political and economic development in Iran .....	24
3. The presidency of Ahmadinejad.....	27
4. The development of the nuclear program activities .....	32
<b>CHAPTER III. EUROPEAN UNION SANCTIONS ON IRAN .....</b>	<b>44</b>
1. Relations between Iran and EU .....	45
1.1. History of EU/Iran economic cooperation.....	45
1.2. Sectors of EU/Iran cooperation in trade .....	46
1.3. Bilateral economic cooperation between Iran and individual EU members ....	48
1.4. EU economic sanctions on Iran .....	50
2. Critical Analysis .....	61
2.1. Assessment of efficiency of economic sanctions and its impact on Iran .....	61
2.1.1. Political variables.....	61
2.1.2 Economic variables .....	66
2.1.3 Assessment of efficiency .....	68
2.2. Consequences of economic sanctions for EU.....	72
<b>CONCLUSION.....</b>	<b>77</b>
<b>BIBLIOGRAPHY.....</b>	<b>83</b>

## INTRODUCTION

“European Union position is based on the firm belief that an Iran with nuclear weapons risks triggering a proliferation cascade throughout Middle East. This is the last thing that this region needs. A nuclear weapons-free Middle East remains a European goal” (Ashton, 2010). The EU has a clear stand toward a development of nuclear weapon in Iran. It has made many diplomatic efforts to prevent Iran from such actions however they have shown no success. Iran has tricked EU and the whole international community several times by concluding agreements that were very soon breached. Ever since 2003, IAEA (International Atomic Energy Agency) has had doubts about the character of Iran`s nuclear program as well as about the honesty of Iran`s cooperation with IAEA (Farrar-Wellman, 2010). However the first more serious actions by the EU3 (France, Germany and United Kingdom(UK)) were proposed only in 2009 and even than not all the EU members agreed on such actions (Dinmore, Bozorgmehr & Barker, 2009). Only in 2012, EU finally decided to unilaterally impose stricter economic sanctions. The part that most affected Iran was the EU ban on the importation, purchase and transportation of Iranian crude oil, since the 27 members account for about 20% of Iran`s oil exports (BBC News, 2012). Iran is a very controversial country and has because of its actions problems in relations with several countries in the international community. It also has a history which shows that its disputes rarely come to a conclusion. Whether the economic sanctions have any potential for success, what changes will they bring for the relevant countries in the international community and how will they affect the EU members, are the areas that I will research in this thesis.

The *aim* is to form a thesis that will show some new conclusions on the consequences that the EU economic sanctions against Iran bring. The *added value* of this thesis is a different perspective on the influence of economic sanctions. The research will include the implications for both sides, but the main focus will be on the consequences the economic sanctions have for the sender. I believe this perspective is less common in research, since the sanctions are aimed to harm the target country. However they usually also have bad implications for the sender if they are not imposed right. The sanctions bring a lot of

changes and I believe, since this is a very recent set of actions, there is not much academic literature that has been written on the consequences that these sanctions will cause for EU and other members of the international community. Therefore my research will more extensively explore also this dimension. This topic is relevant for the current and the future relations between EU and Iran and also for the situation in the whole international community. Iran is a very difficult partner to work with and its nuclear program brings worries for everyone. Therefore it deserves a lot of attention and a better understanding of the main problems and implications it brings for everyone in the international community.

— Subject of the dissertation

The main *subject of research* of this dissertation will be the connection among the relations Iran–EU and the consequences that these relations bring. The importance will be given on the position of EU in the international community and the changes it can cause with its behavior. I will investigate the changes that the economic sanctions imposed on Iran bring for individual members of EU that have an established trade relations with Iran; the changes that other relevant countries in the international community will have to meet; the efficiency of sanctions; rationality; and timing of the economic sanctions and the cost of these sanctions for everyone involved. Special focus will be given on the development of the nuclear program, EU's involvement in negotiations with Iran, the power that the imposed economic sanctions really have on Iran, and the consequences they bring for EU.

The *objective* is to investigate if economic sanctions represent an efficient form of measures that could manage to impair Iran's illegal nuclear activities. The second objective of the dissertation is to discover through detail analyses the real consequences that the economic sanctions bring for individual EU members and other relevant countries in the international community.

When writing about the development of Iran as a country my research will be *limited* to the time period between 1990 and 2012, because this is the period important for the understanding of how it all came to the start of Iran's illegal nuclear activities. A special

emphasizes will be given on the present time and the rule of Mahmud Ahmadinejad, who is the main person responsible for all the tensions between EU and Iran. The objective of the dissertation is not the in-depth analyses of Iran history, the relevance for my research begins with the nuclear program which lead to conflicts. The analyses of EU sanction documentation on Iran will be limited up to December 2012, and any further Decisions and Regulations of the Council of EU are not included in this thesis.

— Hypothesis and research questions

EU has had problems with Iran`s moody behavior for a while before it decided to take further measures. They first started with diplomatic negotiations that lasted too long and had no efficient outcome. When the EU decided to take further measures and impose economic sanctions, the world was already facing the global economic crises. These sanctions bring consequences not only for Iran but also for several actors involved, such as EU members and other closely connected countries with Iran and EU.

Therefore my hypotheses are as follows:

**First, the political and economic costs for Iran, caused by the EU sanctions, will not be greater than the political and security costs of complying with EU`s demands, and therefore the sanctions will not be efficient;**

**Second, the EU economic sanctions on Iran bring additional difficulties and insecurities for EU members as well as for other countries in the international community, because they were set up in the wrong time period.**

The research questions that will help to investigate the second hypothesis more in detail are: *How will the economic sanctions influence on individual EU members and their economies in a time of financial crises? What will be the consequences of these economic sanctions for other relevant countries in international community?*

## — Research methodology

In order to answer my research questions and hypothesis I will use the following methodological tools; the analysis and interpretation of primary and secondary sources that will be used in all the chapters. In the first chapter, I will use the *conceptual analysis* as a type of description method, which will help me define the main concepts on which the dissertation is based and of which explanation is important for a better understanding of the whole content of the work. The *description method* will be used to explain the main variables, which are political and economic. These variables will be taken from the book *Economic Sanction Reconsidered* by the authors Hufabuer *et al.*, and their description is crucial since they represent the criteria and basis for the evaluation and analyses of economic sanctions imposed against Iran. I have chosen variables from this specific book, because they are in my opinion most suitable for the case I am analyzing.

A brief explanation of Iranian political system will be made, including the main political institutions, in order to have a better understanding about the functioning of their political system. This part will be formed with the *description method*. The relevant books and online articles will be used.

Partly *historical development analyses* and partly the *description method* will be the methods of research that will help me explain the political and economic development of Iran in the time period from 1990 until 2012. The nuclear program development will be introduced using the *description method* in combination with a *case study approach*. In this sequence the main resources used for the historical development will be the existing books on Iran`s development and also online academic articles. For the explanation of Iran`s nuclear development, primary resources such as Resolutions of United Nations (UN) Security Council and interpretation of the latest information, which I will get from reliable sources such as BBC, CNN, Reuters will be used.

In Chapter III, where the EU–Iran relations and their fields of economic cooperation will be presented, I will use the *analyses and interpretation* of the newspaper articles, EU

publications and various online resources that provide up-to-date information as well as books and surveys that have been written and which will give me more information about the development of these relations. When analyzing the concrete economic sanctions that EU imposed on Iran, the interpretation of *primary resources*, such as Resolutions of UN Security Council and Council of the EU Decisions and Positions as well as other important documents will also be included.

For the purpose of my research I will use the *non-participant observation methods*, because I will focus my research mainly on the analyses of existing literature, documents and complete it with my critical thinking.

#### — Structure of the research

The dissertation is divided on three main chapters: in the first chapter the theoretical or **background concepts** will be defined such as what are the economic sanctions, what types there are, what are the reasons for the use of economic sanctions and a more detailed explanation of embargo which is the main type of economic sanctions imposed against Iran. In this part also the variables that affect on the outcome of sanctions will be defined, they are divided on political and economic variables. These variables are important for the further analyses of the efficiency of economic sanctions.

The second chapter of the dissertation involves the **description and review** of the main relations and events that occur and are important for the analyses. First an explanation of the Iranian political system and its main political organs will be made. This will serve for a better understanding of the functioning of the political system in Iran. Next a political and economic background of Iran's development through the years 1990 until 2012 will be made. I will explain how the country evolved, what changes and problems it faced and a special focus will be given on the presidency of the latest president Ahmadinejad. Further on I will write about the nuclear program in Iran, how it came to the start of the nuclear activities, how the nuclear program developed and what was the reaction of the international community on their illegal nuclear activities.

In the following chapter the **relations between Iran and EU** will be described. Here the importance will be given on the development of their cooperation, the main sectors of trade, the beginning of tensions and the economic sanctions imposed. Information on bilateral trade relations among individual relevant EU members and Iran will also be included. The third chapter also includes **critical analyses** of the consequences and possible outcomes of the economic sanctions imposed. According to the economic and political variables, which were defined in the first chapter of this thesis, an assessment of efficiency of the economic sanctions imposed by EU will be made. I will continue with the implications of the sanctions for the individual EU members that have closest economic relations with Iran. Further on also the considerations of the consequences for other countries involved will be made.

In the final division of the work I will set down my conclusions. Basing on my analysis and interpretation of all the gathered information I will accept or reject my hypothesis and answer the research questions. I will try to expose the questions that are still unresolved and that could be a basis for a future research on the topic.

## CHAPTER I. BACKGROUND CONCEPTS

The main concept studied in the thesis is the concept of economic sanctions. Over the years different authors made various interpretations about what economic sanctions are. The interpretations mostly differ in the means used and the goals they want to achieve. One of the most used definitions of economic sanctions was introduced by *Johan Galtung*. Economic sanctions according to his interpretation are defined as actions initiated by one or more international actors, which are called the *senders*, against one or more others, which are called the *receivers*. These actions can happen for one or both of the two purposes: to punish the receivers by depriving them of some value and/or to make the receivers comply with certain norms the senders deem important (Galtung, 1967, p. 379).

Baldwin (1985, p. 35) identifies three meanings of economic sanctions. First interpretation states the use of economic measures to enforce international law. The second refers to the types of values that are intended to be reduced or augmented in the target state. And the third form of interpreting economic sanctions corresponds to the concept of economic techniques of statecraft. However he is critical of the first two definitions saying that the first definition is too narrowly legalistic and therefore unsuitable for general foreign policy analyses and the second puts more focus on the intended effects of economic sanctions rather than on means to achieve these effects.

Hufbauer *et al.* (2009, p. 3) define economic sanctions as deliberate, government-inspired withdrawal, or threat of withdrawal, of customary trade or financial relations. In this case the term customary means levels of trade and financial activity that would probably have occurred in the absence of sanctions. Economic sanctions are also understood as the economic foreign policy instrument of countries and international organizations, which are in the first place meant to achieve non-economic goals. They usually have a negative aspect, since they represent a form of punishment for a certain unwanted behavior, but there are also positive forms of economic sanctions, that can be applied to change the behavior of another country (Udovič, 2009, p. 49).



Use of economic sanctions under the international law is defined in article 41 of the Charter of the United Nations that states the following:

The Security Council may decide what measures not involving the use of armed force are to be employed to give effect to its decisions, and it may call upon the Members of the United Nations to apply such measures. These may include complete or partial interruption of economic relations and of rail, sea, air, postal, telegraphic, radio, and other means of communication, and the severance of diplomatic relations.

In order to better understand the context of economic sanctions it is important to explain their place in foreign policy of states. States and other subjects in international community use foreign policy to achieve their goals and interests in the international environment. To achieve these foreign policy goals they use foreign policy tools (Petrič, 2010, p. 344). These tools are *economic* measures, *political* measures and *military* measures or measures of *using force* (Benko *cit. in* Udovič, 2009, p. 33). Each foreign policy tool has its internal and external limitations. External limitations usually derive from international law and internal limitations are dependent on public opinion and state laws (*id.*, p. 32).

Foreign policy tools can be separated on *direct* and *indirect* tools of foreign policy. Direct are those that are used in foreign policy and diplomacy in order to achieve concrete foreign policy goals. Indirect are those that express the position of a state in the international community, such as for example membership in international organizations (Petrič, 2010, pp. 344–361).

Economic sanctions are a part of economic measures that are a direct tool of foreign policy. Economic measures can be very different. Most often used are economic sanctions as a form of negative measures and Official Development Assistance (ODA) as a form of positive sanctions (Udovič, 2009, p. 49). Economic sanctions are used very often as complement to or a substitute for other measures such as diplomatic or military measures in order to make them more effective (Benko, 1997, p. 266).

## 1. Types of economic sanctions

Economic sanctions can work best if they are selected and applied considering the profile of the target state. Actors in international community use different types of economic sanctions that can be classified according to their focus. According to the contents of sanctions we can separate between trade and financial sanctions. The country can influence on behavior of another country either with positive sanctions that means with rewarding, or by negative sanctions, which is with punishment. Depending on how many states are involved we can separate between unilateral and multilateral sanctions. And according to the extent of sanctions there are selective sanctions and general sanctions. In this subchapter the latter types of economic sanctions will be revised.

### 1.1. Sanctions as to their contents

#### — Trade sanctions

Trade sanctions impose measures such as limitation of exports and restriction of imports that cause for the target country lost of export markets, denial of critical imports, lower prices received for embargoed exports, and higher prices paid for substitute imports (Hufbauer *et al.*, 2009, pp. 44–45). Countries that carry out sanctions more often use export controls than import controls. This happens because the sender countries are more likely to enjoy a dominant market position as suppliers of key exports. And considering imports there are probably many alternative purchasers of imports (Hufbauer *et al.*, 2009, pp. 91–92). The problem of trade sanctions is that the consequences, especially from export controls, mostly affect the population of the target country (Hufbauer *et al.*, 2009, p. 97).

Limitations of exports are referred as *embargo*. Embargo is a prohibition on exports from the targeted country and can sometimes be used to refer to a ban on all trade (Baldwin, 1985, p. 41). It will be explained more in detail further on. Prohibition on imports or *boycott* means to use different measures that prevent the imports of certain

goods from the target country to the country that imposes sanctions. Countries use boycott as a reaction on certain policy or measures of other country, with which they do not agree. Sometimes it is an action caused by the public, citizens as a consequence of disliking or reluctance of a certain country from where a product originates. The problem of boycott is that it brings also negative consequences for the country that imposes it and its citizens, and it is difficult to hold a boycott for a longer time (Petrič, 2010, pp. 381–382).

#### — Financial sanctions

Financial sanctions can cause for the targeted country interruption of foreign assistance or other official finance, delaying or denying credits or grants and less often with restrictions on private lending or investment. They can be used alone but are usually used in combination with trade sanctions (Hufbauer *et al.*, 2009, p. 46). The most common financial sanctions are the interruption of official development assistance (Hufbauer *et al.*, 2009, p. 96).

The impact of financial sanctions on political balance of the target country can sometimes be stronger than the sender country aims it to be. Financial sanctions have more potential to influence on the government officials that can influence of policy. Financial sanctions can also interrupt a wide range of trade flows even without the presence of explicit trade sanctions (Hufbauer *et al.*, 2009, p. 97).

#### — Asset freezes

Hufbauer *et al.* mention also a third form of sanctions which is asset freezes. This is considered a financial sanction but since it has impacts both on trade and financial aspects it is mentioned separately. A broad freeze of assets not only stops financial flows but also affects on trade, though freezes are often imposed together with broad trade controls. The target country can become very vulnerable if the assets such as merchandise, bank accounts and account receivable of the country, its corporations and

residents is frozen. Usually asset freezes were used during war times, however recently they are used in case of drug traffickers or terrorists (Hufbauer *et al.*, 2009, p. 96). Asset freezes are becoming more popular also as means of targeting the leaders of the rogue regimes, corrupt autocrats, and their associates (Hufbauer *et al.*, 2009, p. 63).

## 1.2. Unilateral and multilateral sanctions

### — Unilateral economic sanctions

Depending on how many countries impose economic sanctions we can talk about unilateral or multilateral sanctions. Unilateral economic sanctions are measures imposed only by one country. In most cases states that decide for unilateral sanctions are economic superpowers that have a certain power and influence in the international community (Hufbauer *et al.*, 2009, p. 111). The success of unilateral sanctions depends on the degree of dependence by the target country on the country imposing the sanctions, and on the speed and ease with which the target country can alter that dependency (Cortright & Lopez, 1995, p. 19).

### — Multilateral economic sanctions

Multilateral economic sanctions can be explained as sanctions that are imposed by two or more countries. In most cases one state is the leading sender of sanctions and he needs to establish a credible commitment to these sanctions in order to convince other states to cooperate (Martin, 1961, p. 12).

Multilateral economic sanctions are most commonly imposed in a framework of a certain international organization. UN Security Council with its decisions is responsible in most cases for the approval of multilateral economic sanctions. If the UN Security Council imposes economic sanctions against a country all the members of UN are obliged to perform them. The same rule is in force in the EU and NATO (North Atlantic Treaty Organization). However the measures imposed by international organizations

have to be first accepted by the member states, as determined in each charter of an organization (Petrič, 2010, pp. 346–348). International organizations tie together a number of issues and provide for its members specific benefits. Therefore it can also facilitate the construction of linkages for a certain leading state that wants to impose sanctions (Martin, 1961, p. 12).

### 1.3. Negative and positive sanctions

Baldwin (1985, pp. 41–42) in his book *Economic Statecraft* separates economic sanctions on positive and negative. All of the mentioned sanctions in this chapter are nominated under the international law and are used in agreements, declarations and treaties as well as in the Charter of UN (Udovič, 2009, p. 49).

#### — Negative sanctions

Negative sanctions are based on threats and punishment for a certain unwanted behavior and actions of another country. Forms of negative economic sanctions are:

##### **(a) Trade sanctions, namely**

- *Embargo*;
- *Boycott*;
- *Tariff increase*, i.e. the increase in taxes on imports from target state;
- *Tariff discrimination*, i.e. the fact that imports from target country may be treated less favorably than those from other countries;
- *Withdrawal of “most favored nation” treatment*, i.e. ceasing to treat imports from a country as similar imports from any other country treated;
- *Blacklist*, i.e. the ban on doing business with firms that trade with the target country;
- *Quotas*, i.e. quantitative restrictions on particular imports or exports;
- *License denial*, i.e. refusing permission to import or export particular goods.

- *Dumping, i.e.* the deliberate sale of exports at prices below cost of production;
- *Preclusive buying, i.e.* the purchase of a commodity in order to deny it to the target country;
- *Threats of the above* — making use of any of the above techniques conditional on certain kinds of behavior by the target.

**(b) Capital sanctions, namely**

- *Freezing assets, i.e.* impounding assets, denying access to bank accounts or other financial assets owned by the target country;
- *Controls on import or export, i.e.* restrictions on who can transfer how much capital for what purposes into or out of the country;
- *Aid suspension, i.e.* the reduction, termination, or slow-down of aid transfers;
- *Expropriation, i.e.* seizing ownership of property belonging to target state;
- *Taxation, i.e.* assets of target state may be taxed in a discriminatory manner;
- *Withholding dues to international organizations, i.e.* nonpayment, late payment, or reduced payment of financial obligations agreed to in the past;
- *Threats of the above.*

— Positive sanctions

Positive sanctions aim to achieve the change in the behavior of another state with promises or providing rewards. Forms of positive economic sanctions are:

**(a) Trade sanctions, namely**

- *Tariff discrimination, i.e.* import duties favoring imports from target state;
- *Granting “most-favored nation” treatment*—promising to treat imports from target state as favorably as imports of similar products from any other country;
- *Tariff reduction, i.e.* lowering of tariffs in general or on particular products;

- *Direct purchase, i.e.* payment for service or goods;
- *Subsidies to exports or imports, i.e.* exports to or imports from the target state may be subsidized.
- *Granting licenses, i.e.* permission to import or export particular goods;
- *Promises of the above.*

**(b) Capital sanctions, namely**

- *Providing aid, i.e.* extension or continuation of aid or multilateral channels in the form of grant or loans;
- *Investment guarantees, i.e.* governmental insurance against some of the risks of private foreign investors;
- *Encouragement of private capital exports or imports, i.e.* variety of incentives to import or export capital;
- *Taxation, i.e.* especially favorable taxation of foreign capital investment;
- *Promises of the above.*

## **2. Embargo**

The purpose of embargo, as a type of economic sanction, is to prevent that the country against which the embargo is targeted at gets certain goods and products. Embargo can be imposed by one country or by a group of countries, a regional organization or UN. It is usually difficult for only one country to impose an effective embargo and prevent the access to certain goods and products to a certain country against which the embargo is imposed. An effective embargo can be alone carried out only by superpowers, if they get the cooperation of other countries, usually neighbors of the country under embargo. More often, than by an individual country, is embargo imposed by an international organization. Embargo includes usually only certain products or goods for example arms or technological items. However embargo even if imposed by the UN is very often breached, because the illegal trade with arms is a very profitable part of economic activities (Petrič, 2010, pp. 380–381).

Embargo is mainly put in place by the UN and the EU. The main aim of UN embargoes is, as stated in the UN Charter, to implement decisions by the Security Council to maintain or restore international peace and security. On the other side EU imposes embargoes for the purposes of its Common Foreign and Security Policy objectives (Business Link, ND). The aims are to preserve peace and strengthen international security, to promote international co-operation and to develop and consolidate democracy and the rule of law and respect for human rights and fundamental freedoms (Council of the European Union, ND).

Embargo can be either temporary or permanent. However in most cases embargo is only a temporary measure (Brown & Sadler, 2012, p. 1). Embargo can also be selective or comprehensive depending on how many areas it covers (Tostensen & Bull 2002, p. 374).

### **3. Change in economic sanctions**

After 1990, a certain shift from comprehensive sanctions to targeted and selective sanctions has occurred as a response to bad consequences that comprehensive sanctions caused and in order make sanctions more effective. Comprehensive economic sanctions cause great humanitarian damage since they impact most the innocent and vulnerable populations, and not so much the political elites where the real policy changes can occur (Cortright & Lopez, 2002, p. 2). In some cases regime leaders and their loyal supporters escape practically unharmed (Hufbauer *et al.*, 2009, p. 138). Especially the UN experiences with sanctions against Iraq and Haiti that caused great collateral damage to ordinary civilians started the search for better options. The goal has therefore become to find methods of economic pressure that can more effectively convince elites to change objectionable policies (Cortright & Lopez, 2002, p. 2).

This led to the formation of “smart sanctions”. Smart sanctions differ from conventional sanctions in two ways: they more effectively target and penalize political elites and they protect the vulnerable social groups such as women, children, and elderly from collateral damage by exempting specified commodities, such as food and medical supplies, from



the embargo (Totensen & Bull, 2002, pp. 373–374). Smart sanctions are designed to apply maximum pressure on the culpable actors while at the same time minimizing the adverse humanitarian impacts (Taylor, 2010, p. 23). They are targeted and selective. Targeting focuses coercive pressure on those responsible for wrongdoing, while minimizing unintended negative impacts. Targeting also means selectively sanctioning specific products or activities that are important and valuable for the decision makers (Cortright & Lopez, 2002, p. 2). Smart sanctions usually come in the form of arms embargoes, travel bans, asset freezes and selective banking sanctions (Hufbauer *et al.*, 2009, p. 138).

#### **4. Variables that affect sanctions**

The variables that affect economic sanctions are very important because they influence on the outcome and consequences. The variables will help me evaluate if the economic sanctions imposed by EU can stop Iran. In this chapter the variables will be defined and explained. I will rely on the variables determined by the authors Hufbauer *et al.* that have made a research about sanctions and their effects in their book *Economic Sanctions Reconsidered* (2009). The variables will be divided on political and economic. Some alterations and adjustments have been made to these variables in order to best fit the analysis of this dissertation.

##### **4.1. Political variables**

This includes:

###### *— Companion Policy Measures*

Companion policy measures are imposed if economic sanctions don't have enough influence on the target. They serve as additional measures. We can distinguish three types of companion policies: *covert action*; *quasi-military action* and *regular military action*. Covert action is often used when the destabilization of a target government is sought. Quasi-military force may be imposed where major policy changes are sought, as

for example massing troops at the boarder or stationing war vessels off the coast. Economic sanctions may also be accompanied with actual armed hostility when using regular military action (Hufbauer *et al.*, 2009, p. 57).

— *International cooperation*

In order to make economic sanctions successful, an international cooperation has to be established between the leading country and the other actors. The aim is to deny the target country access to suppliers or markets of its target partners. For the sender country more cooperation is always better than less, however the critical variable that influences on the amount of cooperation is usually the nature of the objective (Hufbauer *et al.*, 2009, pp. 57–59).

— *International Assistance to the Target Country*

The support offered to the target country is the opposite side of the international cooperation working with the sender country. Target countries are very rarely completely isolated and abandoned by all the markets and financial sources when economic sanctions are imposed. The impact of economic sanctions can be reduced if the target countries have friends that offer them support and help them compensate for the burdens imposed by sanctions. It can happen that target countries turn sanctions to their economic advantage if they cooperate with the opponents of the sender country (Hufbauer *et al.*, 2009, pp. 59–60).

— *Prior Relations between Sender and Target Country*

The degree of sanctions depends on the relations between the sender and the target country. With friends, subtle or symbolic sanctions may succeed. A friendly country will consider the relation it has with the sender country before it responds. On the other side with belligerent countries forceful sanctions may be needed. For the classification of prior relations between the sender and the target the following index will be used:

- *Antagonistic*: the sender and the target countries are in opposing camps;

- *Neutral*: the sender country does not have strongly connected relations with the target, but there is a workable relationship without antagonism;
- *Cordial*: the sender and the target countries are close friends and allies (Hufbauer *et al.*, 2009, pp. 60–61).

— *Political Regime of the Target Country*

Determining whether the system is democratic, autocratic or has dimensions of both, depends on certain indicators such as the institutionalized competitiveness of political participation, the regulation of political participation, the openness and competitiveness of executive recruitment and the institutional constraints on the exercise of executive power (Hufbauer *et al.*, 2009, p. 61).

#### 4.2. Economic Variables

This includes:

— *The size of the sender and target country*

The outcome of sanctions may also be influenced by the relative size of the sender and the target country. Usually the sender country should be larger and its GDP should be bigger than in the target country in order to make sanctions really effective (Hufbauer *et al.*, 2009, p. 62).

— *The trade linkages*

The sender countries are usually very large economies and the target's import and export trade with the sender normally accounts for over 10% of the target's total external commerce. This way an interruption in trade, even in a very small portion, can cause unpleasant consequences for the target country (Hufbauer *et al.*, 2009, p. 90).

— *The types of sanctions used*

Success of the type of sanctions used may depend on whether the sanctions hit a sensitive sector in the target country. If an authoritarian government controls the target country, the impact of sanctions will be weakened because the elite usually shift the burden of sanctions to the general population. The formation of economic sanctions needs to be done very carefully because the specific measures will differently affect also home firms and communities (Hufbauer *et al.*, 2009, pp. 90–91).

— *The economic health and political stability of target country*

The economic and political atmosphere also influences on the sanctions imposed and its outcome. The judgment scale that will be used to evaluate the environment that the target government is facing:

- *Distress*: a country with acute economic problems, which is seen by high unemployment and rampant inflation, as well as with political unrest that borders on chaos;
- *Significant problems*: a country that faces severe economic problems in the form of foreign exchange crisis, coupled with substantial internal dissent;
- *Strong and stable*: a country with the government in firm control and with economy that faces only the normal range of inflation, unemployment and similar ills (Hufbauer *et al.* 2009, pp. 62–63).

— *The estimating costs of sanctions to the target countries*

Economic costs, both to the sender and to the target, help determine the success or failure of the imposed sanctions (Hufbauer *et al.*, 2009, p. 101). The higher the net cost to the target, the more likely they will alter its policies. The estimated costs will be related to the change in the GDP of the target country (Hufbauer *et al.*, 2009, p. 62).

## **CHAPTER II. IRAN POLITICAL AND ECONOMIC BACKGROUND**

Iran's political system is the factor that has a great influence on its behavior. The influence of each political institution within the country depends on the political orientation of most members. Currently the most influential coalition are the radical group, which have the support of the Supreme leader, the Guardian Council, have most of the seats in the Parliament and also the current president Ahmadinejad belongs to this coalition. The political and economic development of Iran has been much influenced by different political coalitions that were ruling the country throughout the past.

Ever since 2002 there have been serious doubts about the peaceful nature of Iran's nuclear program (Federal Foreign Office, 2012b). Because of these suspicions several members of international community proposed diplomatic measures in which they would help Iran develop a modern civil nuclear power program and try to solve the problem with different proposals (Farrar-Wellman, 2010). However Iran refused the offers and continued with building new enrichment plants. UN Security Council has issued a number of Resolutions that are legally binding and that are suppose to make Iran comply with the IAEA demands on peaceful use of nuclear program (Federal Foreign Office, 2012b).

In chapter two the main topic will be the political and economic development of Iran, and the start of the nuclear program. In order to understand Iran's behavior and actions, this second chapter will also revise Iran's political system and its main political institutions.

### **1. Iran political system**

Iran is located in the Middle East and shares borders with seven countries: Armenia, Azerbaijan, Afghanistan, Pakistan, Iraq, Turkey and Turkmenistan. With its 1,648,195 sq km it is the 18 largest country in the world (CIA, 2012). Iran income level is ranked according to the World Bank to the upper middle income. Its GDP (Gross Domestic Product) has in 2009 reached \$331. 0 billion (The World Bank, 2012), and the real GDP

growth in 2011 was 2%, which is almost 4% less than in 2010 when it reached 5, 9% (International Monetary Fund 2012, p. 72). The main problem of Iran`s GDP is the high dependence on oil and very low non–oil GDP growth. The problem that also troubles the country`s economy is the high inflation (Tehran Times, 2010).

In 1979 the Islamic Republic of Iran was established with a theocratic system of government. The political system is a mix of appointed and directly elected institutions (Aljazeera, 2009). The main political institutions are: Supreme leader; the President; Assembly of Experts; Expediency Council; Guardian Council; Islamic Consultative Assembly; Supreme Court and the Council of the Judiciary (CIA, 2012).

### 1.1. The Supreme leader

The Supreme leader represents the highest ranking political and religious authority in the country. His role is to appoint chiefs of posts such as the commanders of the armed forces, chief judges, prosecutors and also the six Islamic jurists of the Guardian Council (Aljazeera, 2009). Ayatollah Ali Khamenei is the current Supreme leader of Iran since 1989 and he has constitutional authority over all the branches: executive, legislative, judicial, and he also influences on the military and media (United States Institute of Peace, NDc). In domestic politics he represents the mediator in the competing themes of republicanism and theocracy. However the current Supreme leader leans toward a more conservative ideological stance (Green, Wehrey & Wolf, 2009, p. 8). His performance is monitored by the Assembly of Experts (Aljazeera, 2009).

### 1.2. The President

The President of Iran is, since 2005, Mahmud Ahmadinejad. He is the Head of government and oversees economic policy and the management of national affairs, selects the Council of Ministers, chairs the national Security Council and signs agreements with foreign governments (Aljazeera, 2009). He represents the executive branch together with the Supreme leader and the Council of Ministers. The Council of

Ministers is appointed by the president with the approval of the legislative branch (CIA, 2012). The President does not have any authority over the armed forces and security forces. He is elected by popular vote, but his acceptability has to be confirmed by the Supreme leader (Crane, Lal & Martini, 2008, pp. 12–13).

### 1.3. The Assembly of Experts

It is the only body that can appoint and dismiss the Supreme leader. It is considered together with Expediency Council and Guardian Council a part of the oversight bodies of the executive branch. The members are popularly elected every 8 years (United States Institute of Peace, NDa). Even though it is an elected body, with each province choosing a number of representatives according to its population, the Guardian Council must vet all the candidates (Crane, Lal & Martini 2008, p. 11).

### 1.4. The Expediency Council

It represents a council appointed by the Supreme leader (Crane, Lal & Martini, 2008, p. 12). It is the supervisory authority over the executive, judicial and legislative branches, it also resolves issues and differences that the Council of Guardians and the Islamic Consultative Assembly (the Parliament) may face (CIA, 2012). The body was established by the Supreme leader in 1988 in order to reduce the power of conservatives in the Guardian Council. It has weakened the ability of the Guardian Council to reject law passes by the Parliament at will (Crane, Lal & Martini, 2008, p. 12).

### 1.5. The Guardian Council

The Council consists of 12 jurists (Crane, Lal & Martini 2008, p. 11), and it has the constitutional authority to veto parliamentary decisions and vet electoral candidates. It determines whether proposed legislation is both constitutional and faithful to Islamic law and also supervises national elections. It is an unelected body, half are appointed by the

Supreme leader and the rest by the Parliament (CIA, 2012). The member of the Council can serve for six terms (Crane, Lal & Martini 2008, p. 11).

#### 1.6. The Islamic Consultative Assembly

Islamic Consultative Assembly or the Parliament is the national legislative body (CIA, 2012). It consists out of 290 publicly elected members. It has a weak role compared with the presidency, as well as with the non-elected institutions such as the Guardian Council (United States Institute of Peace, NDb). The candidates must be vetted by the Guardian Council. This rule has brought many problems in the last two elections where many reformist candidates were not allowed to run, since the Guardian Council favors the right coalition (Crane, Lal & Martini, 2008, p. 13).

The presence of formal political parties in Iran is still very new. The conservative part usually works through political pressure groups and not in parties. Political parties are normally formed in the time of elections however they break up soon after the election finish (CIA, 2012).

#### 1.7. The Supreme Court and the Council of the Judiciary

They represent the judicial branch and together they supervise the enforcement of all laws and establish judicial and legal policies (CIA, 2012). However judiciary decisions are never final in Iran, because influential clerics can justify the ruling as un-Islamic and may demand a different ruling (Crane, Lal & Martini, 2008, p. 12).

#### 1.8. The Revolutionary Guard Corps

Armed forces are an important factor in Iran. The Revolutionary Guard Corps were first established in 1979, after the revolution, to protect and defend the regime against threats. However today they still represent an important part in Iran's politics. The



Revolutionary Guard Corps veterans have a 16% share of seats in the parliament (Bruno & Bajoria, 2011). Half of the President Ahmadinejad's cabinet consists of former Revolutionary Guard Corps officers and he also appointed several officers to provincial governorship (Alfoneh, 2008).

## **2. Political and economic development in Iran**

In this subchapter, the political and economic development of Iran will be researched in detail. I will emphasize the main political coalitions and their rivalry for the leading position in Iran. It is important to know more about the political development and political coalitions in Iran in order to better understand the behavior of Iran in international community. The historical background will be limited, it will not include the whole history, because it's too broad and not relevant for this work. I will focus on recent historical developments such as presidency of Rafsanjani, Khatami and most importantly the Ahmadinejad presidency. They are relevant for the understanding of the conflict with EU, the establishment of the nuclear program and the assessment of economic sanctions imposed.

### **— Political coalitions**

In Iranian politics there are three main poles; the *left* coalition, the *right* coalition and the *center*. Each side is represented by influential politicians that strive to conquer the leading position in the country. Ideological criterion such as left and right in Iran differs from the one we know in the European tradition. The left is understood by the Iranian political scientists as the clergy group that advocates for reform of the Iranian political system, the so called reformists. The opposing side, the right, is against reforms (Filin, 2011). The left advocates the respect of people's rights and political freedom. They believe that the guarantee of legal and political freedoms is most important for social and political growth. The main leader of the left is the former Iranian president Mohammad Khatami (Asayesh *et al.*, 2011, p. 222).

The right splits into two groups, the *conservative* and the *radical* group (Filin, 2011). Its origin comes from the Shiite tradition and its main thinking is based on the idea that a country should be governed by a religious ruler (Asayesh *et al.*, 2011, p. 222). The right's economic policy strives toward laissez-faire capitalism, which means they oppose land reform, state control over major industries, controls on foreign trade. They want to remove the secularized legal system and impose Islamic legal codes. The main representative of the right's radical group is the current president Mahmoud Ahmadinejad. The right also has the support of the Council of Guardians (Wells, 1999, p. 30).

The center takes some orientations from the right and some from the left. On economic matters they tend to lean more toward the right, on legal and cultural issues they tend to side with the left and are only partly supporting the alteration of the legal and educational system in the country. They also oppose the rights idea of removing all secular legal codes. They are referred as Rafsanjanists, since their informal leader is former president Rafsanjani (Filin, 2011). The main characteristic of the center is pragmatic approach to many political issues, therefore they are known as pragmatists (Wells, 1999, pp. 30–31).

*The Supreme Leader* also plays an important role in Iranian politics. His role is to work as an arbiter between various groups of power, however he especially supports the right coalition (Filin, 2011). Despite the right's control dominance over most of the institutions of state power, there has been a development in Iranian politics toward a more pluralist politics. There are more than 200 political parties, associations and organizations registered in the country (Green, Wehrey & Wolf, 2009, p. 96).

#### — Political and economic development in Iran

In 1979 the Islamic revolution took its place. The revolution established the Islamic Republic of Iran and gave Ayatollah Khomeini the position of the Supreme Leader. The war with Iraq, that was started by Saddam Hussein in 1980, brought great human

sacrifice, physical destruction and financial losses and it affected Iran in a great matter (Katouzian & Shahidi, 2008, pp. 3–4). The war was finished in 1989 and Iran had to find solutions to the main problems such as revival of exchange relations, rejection of the dictates of the state and giving more freedom to private entrepreneurs (Filin, 2011). The same year was marked also by the death of the Supreme Leader Ayatollah Khomeini and the beginning of the post-Khomeini period. His successor, the new supreme leader, became Ayatollah Khamenei (Katouzian & Shahidi, 2008, p. 4).

The president of the post-Khomeini period was Hashemi Rafsanjani. The period of his ruling was known as the era of reconstruction. The main focus in this period was the reconstruction of the country after the war however little effort was put into democratic and political development (Asayesh *et al.*, 2011, p. 221). The Pragmatists tried to pursue an economic reform and make the situation in the new country more normal. However the problem was that an economic reform was not possible without a political reform (Iran Politik, 2012).

Reformism emerged in 1990, mostly because of dissatisfaction with the Rafsanjani regime and their incapability of dealing with economic and political problems that the country was facing. Reformists saw the solution to economic difficulties in the beginning of the process of democratization in earnest, with the focus on the civil society development and reconstruction of economy (Ansari, 2007, pp. 17–18). However Rafsanjani was re-elected in 1993 and remained president until 1997 elections. He began to cooperate with the left, soon after the re-election, to work together against the right and their aggressive tactics. In the parliamentary elections in 1996, the Council of Guardians, that was ruled by the right coalition, banned nearly all of the left coalition members and excluded the left from participating in the parliamentary elections. When the presidential elections came in 1997, the right did not have a strong candidate and the left's main candidate Muhamad Khatami, gained the support of a number of left and centre professional organizations. He was known as the freedom candidate and he won the elections with 69% of votes (Wells, 1999, pp. 34–37). His victory was a consequence of voters wish for more-democratic and socially liberal views (Crane, Lal

& Martini, 2008, p. 29). This was the beginning of the third period, the reform era (Asayesh *et al.* 2011, p. 221).

In 1999, Khatami introduced to the country the concept of nationwide municipal elections as a start of the development of civil society and electoral culture (Ansari, 2007, p. 27). He wanted to put in practice all of the goals he set up during his campaign such as; implementation of constitutional civil rights, free dissidents and institute a level of equality for men and women in the framework of the existing order (Wilfried, 2000, p. 123).

However, there have been several problems in the time of Khatami presidency that made the ruling more difficult. Most of these problems relate to ongoing reconstruction efforts, poor state of the economy, inflation, unemployment, and unrest in countryside (Wells, 1999, p. 38). The most significant economic improvement in the Khatami presidency was the unification of the exchange rate, which enabled that all international transactions have been conducted at one, unified rate (Crane, Lal & Martini, 2008, p. 87). An Economic Rehabilitation Plan has been formed in order to reform the country's economy, however it has failed to provide a clear and consistent strategy to save the problems that the country was facing. By the early 2000, the economic situation of Iran further deteriorated. The main problem of Iran's economy was the big dependency on oil. Approximately 80 percent of Iran's foreign income has come from oil. The prices of oil have drastically dropped in the time period of Khatami presidency and Iran's income has fallen extensively. The president has unsuccessfully tried to diversify and stop the country's extreme oil dependence. The economic challenges that Khatami was facing were enormous and they affected his popularity in a negative way (Wilfried, 2000, pp. 171–172).

### **3. The presidency of Ahmadinejad**

The last years before the new elections Khatami remained focused on finishing his presidential term in peace and quiet (Haghighi & Tahmasebi, 2006, p. 964). Since he

was already president for two terms he could not run for this position anymore. The right took this opportunity and put much effort in finding the right candidate that would help them come to the leading position of Iran. The strictly religious forces in Iranian society were of opinion that Khatami caused, with his political and social reforms, the disappearance of religious beliefs, especially among the youth. The working class was also unsatisfied with the situation in the country, and the new elections called for a candidate that was not so publicly known and was outside the sphere of power. Ahmadinejad was a candidate that campaigned as an outsider and who claimed not to have any ties with the ruling clique (Haghighi & Tahmasebi, 2006, p. 966). He came to the political sphere as a very unknown and unestablished candidate in the political arena. In 2003, he became the mayor of Teheran and this was the start of his public career. As a mayor he already showed his ultraconservative ideas of ruling, such as building parks only for women, reconstructing cultural halls into religious facilities and passing new policies to eliminate the financial separation of church and state (Jafarzadeh, 2007, pp. 21-23).

When election period in 2005 began, the Guardian Council prohibited all the women to run for president because it was not in accordance with the constitution (Jafarzadeh, 2007, p. 26). Ahmadinejad registered as a candidate only on the last day. He presented himself as a humble man, coming from the poor, who served his country in the war and who wanted to listen and help the people of Iran (Ansari, 2007, p. 38). Ahmadinejad was a representative of a modest lifestyle as a contrast to the wealth and corruption of his main opponent Rafsanjani (Crane, Lal & Martini, 2008, p. 30). He had the support of the Supreme Leader as well as the Guardian Council which both wanted someone from the ultraconservative side to rule the government. His main opponent in the elections, the former president Rafsanjani, was expected to win according to the first count of votes. The Interior Ministry, which was in charge of counting the votes, announced that Ahmadinejad was only on third place after the first round of elections. However the Guardian Council announced its own turn out that stated that Ahmadinejad and Rafsanjani come to the second round of elections because they had almost the same number of votes, the total vote tally was nearly 3 million votes higher than the Interior

Ministry's count. This all lead to suspicions and accusations of fraud. In the second round of elections the victory of Rafsanjani was almost certain, however the turnout showed that Ahmadinejad received most votes and that voter turnout was an incredible 60 percent (Jafarzadeh, 2007, pp. 28–29). This again caused an outrage over the results and accusations that some voters have been pressured or bribed to vote in favor of Ahmandinejad. The accusations also implied that he could not reach the results that he has without illegal assistance by the Supreme Leader's son, the Guardian Council and the Revolutionary Guard Corps and paramilitary organization Basij (Crane, Lal & Martini, 2008, p. 30).

The victory gave the right control of Iran's two highest election offices – the presidency and the parliament – as well as a freer hand to the non-elected theocracy, which is responsible for approving all the important policies (Gannon, 2005). The government soon started to introduce its repressive measures. First one was the repression and arrests of intellectuals. The arrests have served to warn the academic community to avoid contact with foreign and diaspora colleagues, but it soon lead to government's loss of support in the population at large. Another one of Ahmadinejad's measures affected the Universities, as he decided to give the Universities a cultural revolution. With this he wanted to stop the secular education and also to close down the intellectual debates within universities as well as reducing the linkages that the universities had abroad. The repression of intellectual activity was presented as an act of national purification, since Ahmadinejad had the opinion that intellectuals polluted the purity of the Islamic revolution (Ansari, 2007, pp. 76–77). His hardliner conservative views were seen also on his pressure on the authorities to demand stricter Islamic dress code and the further repression of women rights. His rule was focused on establishing an ideal Islamic society and the external goal of founding global Islamic rule (Jafarzadeh, 2007, pp. 34–35).

The economic situation in Iran was still critical when Ahmadinejad began his presidency. At the beginning of his mandate it was expected that he would use the oil windfall to initiate an extensive program of infrastructural projects, putting people to

work, increasing salaries and rejuvenating the industrial base of the country. Most of all he was expected to overcome the main problem of Iranian economy that was and still is the dependence on oil revenues alone, and achieve a diversified economy based on tax and manufacture (Ansari, 2007, pp. 79–80). His goal was also to continue with the reforms that Khatami started, such as additional reductions in tariffs, and the privatization of state-owned enterprises (Crane, Lal & Martini, 2008, p. 94).

However, Ahmadinejad's actions and policies soon showed that this will not be achieved. As the president decided to use Iran's oil wealth on domestic investments and block foreign investments together with isolationist measures it became clear that the idea of establishing economic transparency in Iran, that is the main precondition of foreign investments, was very fast abandoned. It also became clear that Ahmadinejad's plans of expenditure did not result in investments of any kind and no one knew where exactly the money was going (Ansari, 2007, p. 81). Ahmadinejad has made a lot of damage to the state economy also by imposing different economic policies such as targeting loans to favored firms, resorting to fuel rations rather than reducing the fuel price subsidy and his new privatization program seemed to be a way of rewarding regime supporters and preserving state control (Crane, Lal & Martini, 2008, p. 94). Despite the promotion of privatization, the government continued with preferential treatment of state owned entities and the companies owned by the Revolutionary Guard Corps also enjoyed an increase of their role in economy (Green, Wehrey & Wolf, 2009, p. 23).

The troubles enhanced since Iran was already unable to purchase goods from US, as the consequence of US sanctions, and the rising costs in Europe and the Far East were making the situation even worse. By the end of 2006 it became clear that the countries uncontrolled spending brought consequences in the form of inflation. The dramatic increase in liquidity and the reckless government spending had not been matched by any increase in available goods of domestic production, and consequently the prices went up. Iran has a trade based economy and this type cannot function in an isolated environment (Ansari, 2007, pp. 82–84). The economic policies for protection of domestic industries

by import reductions have made domestic producers even more inefficient for competing on international markets. Such economic policies have made the country even more dependent on oil and tax revenues (Crane, Lal & Martini, 2008, p. 95). And the fact that tax revenue makes up only about a fifth of the Iranian government's budget again showed the main weakness of Iran, that is a strict dependence on income from oil (Ramin & Daragahi 2008). Ahmadinejad's method of reducing the inflation was drawing down bank interest, which significantly jeopardized the independence and function of the Central Bank of Iran (Green, Wehrey & Wolf, 2009, p. 24).

As the business in Iran in 2006 was coming to a standstill also Ahmadinejad's support went down, from the side of the mercantile elite as well as from the poor. He was also getting critics from the Parliament, whose constitutional duty was to scrutinize the government's budgets and economic policy, however Ahmadinejad showed few concern about this and frequently refused to turn up for question time in the Parliament (Ansari, 2007, p. 84). The main element spoiling the economy was the excessive political control and interference in both decision-making and implementation. The elite remained in charge of economy and used it as a tool for gaining greater power (Green, Wehrey & Wolf, 2009, p. 24).

In 2009, the presidential elections took place and everyone was expecting a change. However, the results of the elections once again showed the corrupt nature of Iranian politics. The main opposing candidate Moussavi had a strong lead in the final days of the campaign. But the Interior Ministry once again declared that Ahmadinejad has won with 62, 6 % of the vote and that his challenger received only 34%. Similar as the first time the turnout on the elections was extreme and reached 85%. Surprisingly the results of the elections were known already 2 hours after the elections, which provoked further suspicions (Worth, 2009). The results of elections were followed by street protests. The Revolutionary Guards tried to suppress the protests, which resulted in several deaths and many prosecutions of protesters (Bednarz & Follath, 2009).



#### **4. The development of the nuclear program activities**

— Beginning and early developments of the nuclear program in Iran

Iran's nuclear program has been launched in the 1950s, and the first small 5 megawatt (MW) research reactor was built in Teheran with the technical assistance of the US (Lotfian, 2008, p. 159). The assistance by US was a part of program "Atoms for Peace", in which nuclear energy technology was given to nations throughout the world in exchange for commitments of those countries that they would not develop nuclear weapons (Jafarzadeh, 2007, pp. 129). The US found it crucial to promote Iranian power in order to help them police the Persian Gulf region in times when the US were committed in Vietnam (Cronin, 2008, pp. 13–14). In 1968, Iran signed a Treaty on the Non-Proliferation of Nuclear Weapons and ratified it in 1970. In 1974 an agreement with IAEA was signed, called the Safeguards Agreement, to allow full inspections of all Iran's nuclear material. The same year also the Atomic Energy Organization of Iran (AEOI) was established, and a 20-year nuclear energy plan that included building 22 power reactors throughout the country was formed. The US and Iran also signed an agreement to exchange nuclear technology and cooperate in nuclear safety (Jafarzadeh, 2007, pp. 129–30). There were two main reasons why Iran was interested in the nuclear program at that time. The first was its energy plan based on optimum utilization of energy resources: oil, gas, hydro and nuclear. They wanted to achieve a large diversification of sources of energy in order to reach an optimal energy mix and to have a more flexible system of energy supply. The second reason was the rapid industrialization that was happening in the country at the time. Iran wanted the access to nuclear technology in order to take advantage of various applications of this technology in its scientific and industrial activities (Askarieh, 2008, p. 189).

Iran signed a contract with West Germany's Kraftwerk Union for the construction of the first nuclear power plant in the Persian Gulf city Bushehr (Lotfian 2008, p. 159), in 1974 they also signed an agreement with France for five reactors, with a further two to be built under license from the US firm Westinghouse (Patrikarakos, 2009, p. 28). After the overthrow of the monarchy in 1979, the nuclear program development was stopped for the

next five years. The revolutionaries that replaced the Shah were against the nuclear program and were of opinion that it is a concept imposed from the West that they don't want to support (Lotfian 2008, p. 160). The nuclear program was too expensive and according to the authorities ideologically unclean, therefore the government, in 1979, announced the unilateral abrogation of all the contacts made with Germany and France (Patrikarakos, 2009, p. 30).

Despite that nuclear developments continued through the 1980s. In 1984 Iran built a new nuclear research laboratory at the Esfahan Nuclear Technology Center, which was the center that was originally intended for training the personnel that would work in the Bushehr reactor. The crucial partner that helped Iran at this point was China. China was involved in the expansion of the centre, which has grown more than necessary for peaceful research (Jafarzadeh 2007, p. 131). In 1985, China and Iran concluded a protocol of cooperation on the peaceful use of nuclear energy. The agreement was not officially acknowledged at the time, but under the agreement China helped Iran develop the Esfahan Nuclear Technology Center. The work in the center included the research of reactor technology, the nuclear fuel cycle, including uranium enrichment, and the chemical reprocessing of depleted uranium to extract plutonium (Garver, 2006, p. 143). China assisted Iran on the field of uranium enrichment with providing equipment related to laser enrichment experimentation, and China also represents an important source of raw supplies, providing Iran with natural uranium (Zarif, 2009).

The centre was kept secret and was not declared to the IAEA as a nuclear facility until 1992 (Garver, 2006, p. 143). There are records which show that Iran already in this time, hidden from the IAEA, executed experiments in uranium conversion and fuel production in this center, which was also a strict violation of the Non-Proliferation treaty that Iran signed and ratified. Iran also secretly imported uranium in 1982 for the use of these activities (Jafarzadeh 2007, p. 131). IAEA has only in 2003 after a closer inspection discovered a number of massively built secret rooms used for covered nuclear activities not previously declared to the IAEA (Garver, 2006, p. 143).

Several other agreements followed: a cooperative agreement with North Korea which anticipated Iran's financing of North Korea's modified ballistic missile program in exchange for completed missiles and assistance in developing the Iranian capacity to assemble and produce missile components (Zarif, 2009); a cooperation agreement with Argentina, which anticipated that Argentina would sell Iran 20 percent enriched uranium for use in the small reactor at the Tehran Nuclear Research Center; nuclear cooperation agreement with the Soviet Union. The defeat of Iran in the Iran–Iraq war, was explained by the lack of nuclear weapons on Iran's side. The outcome of war even increased the motivation for developing a nuclear arsenal in the 1980s (Jafarzadeh, 2007, p. 131–132). After the war Iran strived toward a rebuild of the Bushehr reactor that was badly damaged during the Iraq bomb attacks. They asked Germany to resume the work on the facility. However Germany refused, mostly because of diplomatic pressure applied by the US. This has led to a legal dispute between Iran and German company Siemens and Iran claimed damages based on the fact that Iran paid for a nuclear plant that was never finished (Askarieh, 2008, p. 190). In 1995, after long negotiation, an agreement was set between Russia and Iran for the rebuild of the Bushehr reactor. The reactor would have been under the supervision of IAEA and it would be able to produce only maximum 180 kg plutonium per year (Ozcan & Ozdamar, 2009, p. 123).

An important partner for Iran was also Pakistan, which has a nuclear bomb and is developing nuclear technology. Abdul Qadeer Khan, is a Pakistani scientist, that has helped Iran with its nuclear program in the 1980s. In 1987, the Atomic energy commissions from both countries concluded agreements on nuclear cooperation that was followed by a visit of Iran by Abdul Qadeer Khan, than the head of Pakistan's uranium enrichment program (Spector & Smith, 1990, p. 212). According to the agreements between the two countries, Pakistan provided Iran a centrifuge design in order to help them resolve previous unsuccessful attempts to master uranium enrichment technology (Zarif, 2009). The deal between Khan and Iran, that was also made in 1987, included the training of at least six Iranian scientists in two Pakistani facilities, the Institute for Nuclear Science and Technology in Islamabad and The Nuclear Studies Institute in Nowlore. Khan has illegally

sold the overflow of nuclear equipment on the black market, and Iran was one of its first buyers (Jafarzadeh, 2007, pp. 133–134).

— Revelations of covert nuclear weapons program

The Non-Proliferation Treaty, in article IV, declares “(...) the inalienable right of all the Parties to the Treaty to develop research, production and use of nuclear energy for peaceful purposes without discrimination (...)”. Iran, as a contracting state, has used this provision to justify its illegal actions concerning its nuclear program. First revelations of such actions have become known to the international community in 2002, which marks the beginning of the nuclear crises. The Iranian exile opposition group has, in 2002, announced that Teheran hides uranium-enrichment facility at Natanz and a heavy-water plant at Arak. The existence of the sites was also confirmed by satellite photographs. Iran has declared that their program has peaceful aims and that it would allow IAEA inspections (Ozcan & Ozdamar, 2009, p. 123).

IAEA has made a visit to Iran in February 2003. During the visit the AEOI confirmed that a heavy-water production plant, which is not subject to comprehensive safeguards, was under construction near Arak together with a planned heavy-water research reactor. It also declared that a pilot- and commercial-scale gas centrifuge uranium enrichment plants were under construction in Natanz, which was also not reported previously (Kile, 2006, p. 4). After the inspection in 2003, IAEA concluded that Iran violated the IAEA Safeguards agreement by not reporting the nuclear material, as well as the subsequent processing and use of that material, and by not declaring where the material was stored and processed. The whole international community was suspicious that Teheran was working toward a development of nuclear weapon. The fact that AEOI had secret budgets, independent bureaucratic operations and front companies in order to mislead IAEA supervision, made the suspicions even bigger (Jafarzadeh, 2007, p. 142).

In August 2003, IAEA Board of Governors reported that Iran hasn't provided a full access to certain key facilities and at times had provided them with incomplete or

contradictory information. Therefore IAEA adopted, in September 2003, a resolution in which it called on Iran to sign and implement the Additional Protocol of its Safeguards Agreement. The Resolution also stated that it will contact the UN Security Council if Iran fails to resolve all existing issues (Kile, 2006, p 7). The E3 (UK, France and Germany) started a series of negotiations and tried to use diplomacy to communicate with Iran. In October 2003, Iran agreed to temporarily suspend enrichment in exchange for not having its violations reported to the UN Security Council, which could have imposed sanctions upon Iran. However serious disagreements about what the suspension will cover have soon emerged (Taylor, 2010, pp. 61–62). Iran signed the Protocol, but it did not ratify it which has severely restricted the IAEA's inspections to known and declared facilities or inspection only by prior agreement on limited terms. In early 2004, it has become clear that Iran was not prepared to fully cooperate, that there were several new issues that need to be resolved and that Iran's actions did not show any transparency. Furthermore, Iran also declared it would continue to manufacture centrifuges and experiment with Uranium Hexafluoride, two of the activities that most concerned the IAEA (Cordesman & Chair, 2004, p. 53). New information about Iran's connection with Pakistan also became publicly known in 2004. A. Q. Khan, the Pakistani nuclear scientist, has declared that they have provided atomic secrets to Iran, Libya and North Korea since the late 1980. IAEA inspectors have after inspections confirmed similarities in design and components for the P-2 centrifuges, adding suspicions that Khan supplied both North Korea and Iran with the same know-how (Berman *et al.*, 2009, 14).

In fall 2004, E3 were leading negotiation with Iran in order to convince them to suspend the uranium enrichment program. The High Representative for the EU Common Foreign and Security Policy, Javier Solana met with foreign ministers of France, Germany, UK and Iran in Paris where they signed the Suspension agreement (Kile, 2005, p. 15). They have agreed that:

Iran has decided, on a voluntary basis, to continue and extend its suspension to include all enrichment related and reprocessing activities, and specifically: the manufacture and import of gas centrifuges and their components; the assembly, installation, testing or operation of gas

centrifuges; work to undertake any plutonium separation, or to construct or operate any plutonium separation installation; and all tests or production at any uranium conversion installation (IAEA, 2004).

IAEA will be notified about the suspension and will monitor the whole process. The negotiations will continue in order to achieve a mutually acceptable agreement on long-term arrangements. However, the EU efforts showed that the negotiations with Iran are not progressing fast enough. The E3 insisted that Iran has to accept the complete and permanent cessation of the enrichment program, since this was the only guarantee that the program has only peaceful purposes. Iran rejected the demand and claimed that the Non-Proliferation Treaty allows the development uranium enrichment as a part of a peaceful nuclear program. The negotiations started to face serious difficulties (Kile, 2005, pp. 17–18).

In 2005, the radical candidate Mahmmud Ahmadinejad won the presidential elections, and together with countries Supreme Leader they announced that Iran will resume the uranium enrichment, regardless of the agreements with EU and international community (Taylor, 2010, pp. 62–63). In fall 2005, Iran resumed uranium conversion at its Isfahan plant (Ozcan & Ozdamar, 2009, p. 124). The IAEA Board of Governors adopted a Resolution that for the first time, found Iran to be in noncompliance with its IAEA Safeguards Agreement. However, IAEA did not report Iran to the Security Council, but they gave him additional time to comply with the obligations. In January 2006, Iran announced it would resume uranium enrichment and research in Natanz. For this reason IAEA finally decided to report Iran to the UN Security Council. Iran also declared it would not implement the Additional Protocol to the Safeguard Agreement (Kerr, 2012b).

#### — Measures taken by the international community

UN Security Council has as a response to Iran`s violations, in July 2006, passed the **Resolution 1696** (UN Security Council, 2006a), which called for Iran to suspend its uranium enrichment activities within a month and fully cooperate with the IAEA or face the possibility of diplomatic and economic sanctions (Taylor, 2010, p. 63). The E3 has tried to

go further with the negotiations however in fall 2006, EU foreign policy chief Solana declared that five months of intensive talks have brought no agreement on suspension of Iran`s nuclear activities (Berman *et al.*, 2009, p. 14). Since there was no compliance with the Resolution 1696, UN Security Council responded on 23 December 2006 with ***Resolution 1737***.

The Resolution 1737 in its Preamble states the following: “(...) Security Council today imposed sanctions, (...) blocking the import or export of sensitive nuclear material and equipment and freezing the financial assets of persons or entities supporting its proliferation sensitive nuclear activities or the development of nuclear-weapon delivery systems”.

The Resolution further declared, in paragraph 2, the requirements that Iran has to fulfill: “ (...) Iran should, without further delay, suspend the following proliferation sensitive nuclear activities: all enrichment-related and reprocessing activities, including research and development; and work on all heavy-water related projects, including the construction of a research reactor moderated by heavy water”.

The Resolution has, in paragraph 17, also required member states to exercise vigilance and to let Security Council know if any individuals or entities connected to Iran`s nuclear activities was found on their territories (UN Security Council, 2006b). A Security Council Committee was also established with this resolution in order to undertake the tasks set out in paragraph 18 of this resolution. In 2010, the Council has, in the Resolution 1929, further established a Panel of Experts to assist the Committee (United Nations, ND).

In order to continue the negotiations with Iran, China, Russia and US joined the E3 in 2006 and tried to form another proposal for negotiations with Iran (Davenport, 2012a). The new called P5+1 group (five permanent members of Security Council and Germany) presented a proposal (Kerr, 2012a), which included several steps that Iran has to take, such as improve the cooperation with IAEA, suspend all enrichment-related activities and resume the implementation of the Additional protocol. In return there would be a suspension of the discussion of Iran`s nuclear program in the Security Council and an establishment of

several areas of cooperation between EU, US and Iran (Council of the European Union, 2006).

Iran has rejected the proposal of 2006 because of its requirement that Iran suspends its enrichment-related activities (Davenport, 2012a). The P5+1 group proposed a revised version of the proposal in 2008. Iran has presented its own proposal as a response to the P5+1 proposal. They have organized a meeting in Geneva, in order to come to some conclusions on a common proposal however the discussions were inconclusive because Iran refused to make any commitments regarding its nuclear program (Crail, 2008).

During this time the UN Security Council has on 24 March 2007, as a response to Iran`s behavior, adopted the **Resolution 1747**. This resolution doesn`t have any additional requirements for Iran to fulfill, however it does impose new restrictions and expands the scope of the sanctions described in the previous resolution (Kerr, 2007). The new resolution does strengthen, in paragraph 2, provisions regarding the “exercise of vigilance which refers to the entry into or transit through their territories” of certain individuals, by adding additional persons being engaged in Iran`s proliferation activities (UN Security Council, 2007). It further imposes new restrictions on the area of weapons transfer in paragraph 5, stating that: “(...) Iran shall not supply, sell or transfer (...) any arms or related material (...)” (UN Security Council, 2007). In paragraph 6, it also calls on all the states to exercise vigilance and restraint on the sale of certain weapons to Iran, “(...) in order to prevent a destabilizing accumulation of arms” (UN Security Council, 2007). The provisions further, in paragraph 7, call upon states and financial institutions not to give Iran any grants, financial assistance or concessional loans.

IAEA has in its Report by the Director General of November 2007, where they revised the compliance of Iran with the Resolution 1737 and 1747, stated its concern about Iran`s non-suspension of the enrichment related activities. IAEA also warned in paragraph 41 of Report by Director General about two major concerns relating to Iran`s nuclear program, which are: “(...) Iran`s current and past centrifuge enrichment program and the alleged studies (...)”, that could have military applications (IAEA Director General, 2007).



In the end of 2007, new secret information about Iranian enrichment activities became public. The National Council of Resistance of Iran, stated that Iran has stopped the nuclear weapons program in 2003, as the US National Intelligence Estimate was informed, however Iran secretly restarted the program a year later, in 2004 (Berman *et. al.*, 2009, p. 13).

This information and also the new announcement of Iran about its testing and advanced nuclear centrifuge, led to another resolution by the Security Council (Security Council Report, 2012). In March 2008, UN Security Council adopted the **Resolution 1803**, which reaffirms all the calls from previous resolutions and brings additional sanctions. It adds new people to the list of individuals that cannot enter or transit through territories of States because of their involvement in Iran`s proliferation sensitive nuclear activities as well as to the list of the individuals whose funds, financial assets and economic resources need to be frozen (Davenport, 2012b). Further the sanctions include new provisions, defined in paragraph 10, that affect directly the Iranian state: “Calls upon all States to exercise vigilance over the activities of financial institutions in their territories with all banks domiciled in Iran, in particular with Bank Melli and Bank Saderat (...)” (UN Security Council, 2008a). The Resolution also broadens the scope of sanctions on supply, sale and transfer of nuclear and ballistic missile-related items to Iran, in order to stop the development of the nuclear program (Davenport, 2012b). This Resolution, in its paragraph 11, as well calls upon all States also to: (...) inspect the cargoes to and from Iran, of aircrafts and vessels, at their airports and seaports, owned or operated by Iran Air Cargo and Islamic Republic of Iran Shipping Line (...), for prohibited goods (...)” (UN Security Council, 2008a).

The IAEA has in its report on the implementation of the NPT Safeguards Agreement and provisions of UN Security Council resolutions, in September 2008, declared that: ” (...) Iran still has not suspended its enrichment related activities (...)” (IAEA Director General, 2008). End of September 2008, UN Security Council issued another resolution, **Resolution 1835**. This resolution did not bring any new obligations for Iran and did not impose any new sanctions. It has only reaffirmed the four previous resolutions (UN Security Council, 2008b).

— New concerns about Iran`s nuclear program

In 2009, the P5+1 continued diplomatic talk with Iran, for the first time US took part as a full participant, which was the initiative of the new president Obama. They insisted that Iran freezes its uranium enrichment however Iran once again refused the propositions (Reynolds, 2009). In September of the same year, disturbing information about Iranian nuclear program became known to the IAEA, Iran notified IAEA that it was constructing a uranium enrichment facility called the Fordow Fuel Enrichment Plant, near the city of Qom since 2007. They failed to inform IAEA about this activity sooner. Iran`s decision to inform IAEA about the plant, after they have begun with the construction raised concerns that the country could have other hidden facilities (Kerr, 2012a). The IAEA states in the Resolution, adopted on November 2009, that:” (...) Iran's declaration of the new facility reduces the level of confidence in the absence of other nuclear facilities and gives rise to questions about whether there are any other nuclear facilities under construction in Iran which have not been declared to the Agency”. The resolution also urged Iran to stop the construction, clarify the intention regarding the purpose of the enrichment plant in Qom and called on Iran to comply with its safeguards obligations and implement and ratify the additional protocol of the Non-Proliferation Treaty (IAEA Board of Governors, 2009).

In May 2010, Iran signed an agreement with Brazil and Turkey on fuel-swap. The deal determined that Iran ships 1, 200 kg of low-enriched uranium to Turkey in return for fuel for a research reactor. However, this agreement did not bring a solution for the main problem of Iran`s nuclear program, which is Iran`s refusal to halt its enrichment program and address questions about its past nuclear activities (BBC news 2010). Therefore the UN Security Council agreed and adopted a new round of sanctions. Brazil and Turkey voted against such measures, but despite that the **Resolution 1929** was adopted on June 9, 2010 (Security Council Report, 2012).

The resolution reaffirmed all the obligations from the previous resolutions and it “(...) expanded the arms embargo and tightened restrictions on financial and shipping enterprises

related to proliferation-sensitive activities.” It prohibited Iran from acquiring any interest in commercial activities with other states that involve uranium mining, production or use of nuclear material. Besides the arms embargo it also prohibits Iran from doing any activity connected to ballistic missiles (UN Security Council, 2010). The resolution also imposes new inspection regime designed to detect and stop Iranian smuggling, such as inspections of vessels on high seas. The resolution also demanded that states require from their citizens and corporations to exercise vigilance when doing business with Iranian entities that are connected or involved in proliferation efforts (Davenport, 2012b).

#### — Further negotiations

In January 2011, a meeting of P5+1 with Iran followed in Istanbul. They tried to discuss proposals about a fuel exchange for the Teheran Research Reactor and ways to improve transparency through IAEA monitoring measures. However Iran, once again, was not willing to agree with the proposals. The meeting ended with the call of P5+1 to Iran about the need for a demonstration that its nuclear program is exclusively for peaceful purposes (Ashton, 2011). The IAEA report 2011 again stated that Iran has still not implemented a number of obligations and also that Iran is not providing the necessary cooperation with the IAEA, in order to be able to conclude that their nuclear material is for peaceful activities (IAEA Director General, 2011). In addition to Iran’s non-cooperation, the Iran Sanctions Committee was informed by different States several times about Iran’s sanctions violations (Security Council Report, 2012).

In April 2012, diplomatic negotiations between Iran and P5+1 were renewed in Istanbul (Davenport, 2012a). Further round of talks followed in May 2012 in Baghdad where Iran showed that they are more willing to cooperate and also address the issue of the 20% enrichment, however no agreement has yet been made (Borger, 2012). The next meeting took place in Moscow in June 2012. Also this set of talks ended without a breakthrough (Security Council Report, 2012). A technical meeting followed in July 2012 in Istanbul. There are two proposals that were discussed, one proposed by the P5+1 and the other one

by Iran. In Istanbul, both sides came to agree to expert-level talks in order to discuss the technical aspects of both proposals (Davenport, 2012a).

Iran also held talks with the IAEA in Vienna in August 2012. The main purpose was to discuss the access of IAEA to Parchin military site. The negotiations ended without an agreement (Security Council Report, 2012). Parchin is a military site in Iran and suspicions about nuclear activities date back to 2004, when the satellite images showed this might be a site for research and experiments connected with nuclear energy (Hafezi & Dahl, 2012).

IAEA Board of Governors adopted in September 13, 2012 a resolution which once again expressed concern about the nature of Iran`s nuclear program as well as recalled all the past obligations that Iran failed to comply with. It also called for a peaceful resolution of the concerns through diplomatic process (IAEA Board of Governors, 2012). This resolution was supported by P5+1 and also UN Security Council, which shared the same concerns (GOV. UK, 2012).

The P5+1 met in November 2012, and started the next steps of negotiations with Iran (Security Council Report, 2012). However, the IAEA report of November 2012, once again presented disturbing information. They found that Teheran continued to install more centrifuges in Fordow complex and that they continues to experiment with advanced and more efficient types of centrifuges, however they are not yet using them for production-sale operations (Arms Control Association, 2012). IAEA and Iran held talks in Teheran on December 13, to discuss a further path for a better cooperation and to talk about IAEA concerns on Iran`s nuclear activities. The talks were according to both sides constructive and positive, they also agreed on a date for the next round of talks, which is January 16, 2013. The main issue of enriching uranium to 20%, which is the key concern of the international community, remains unresolved since Iran still claims it is their right to do so (Isayev & Jafarov, 2012).

### **CHAPTER III. EUROPEAN UNION SANCTIONS ON IRAN**

Iran and Europe have had contacts with each other for centuries (Tarock, 1999, p. 41). The EU as a whole is Iran's biggest trading partner and Iran is the sixth largest supplier of energy to the EU, and 90 percent of EU imports from Iran are energy and energy related products (Farrar–Wellman, 2010). Iran has especially well developed trade with certain individual members in the EU, such as Greece, Spain, Italy, Belgium (Makanaka, 2012), as well as with Germany, UK and France (Eurostat in The British Iranian Chamber of Commerce, 2011). Iran and the West have argued about the nature of Iranian nuclear program for years. Their economic relations are despite their importance constantly influenced and affected by Iran's illegal activities.

US prohibited nearly all trade and investments with Iran, which is the consequence of Iran's sponsorship of terrorism, refusal to comply with the international obligations on its nuclear program and, its human rights violations (US Department of State, 2012). US have with its hatred toward Iran also a big influence on the EU relations with this country. The fear of the whole international community about Iran's possibility of developing a nuclear bomb has pushed EU into gradually taking further measures for stopping this activity (New York Times, 2012). When Iran failed to restore international confidence in the exclusively peaceful nature of its nuclear program, EU decided to take tougher measures (HM Government, 2012).

This chapter contains a set of information ranging from the start of Iran–EU relations up to the beginning of conflicts and the imposition of economic sanctions. Attention will be given to sectors of trade between Iran and EU as well as trade between individual EU members and Iran. EU's diplomatic measures to solve the issues with Iran and the imposition of economic sanctions will be presented in detail.

## **1. Relations between Iran and the EU**

### **1.1. History of Iran and EU economic cooperation**

EU and Iran have had an Agreement of cooperation in the time of Shah, but it lapsed in 1977, before the Islamic Revolution. Dialogue on cooperation between EU and Iran was first initiated in 1995 and was further extended after the election of president Khatami in 1997 that opened Iranian economy (Commission of the European Communities, 2001). In October 1998, EU General Affairs and External Relations Council asked the Commission to establish contact with Iran in order to see the possibilities for cooperation. A technical meeting was set up with the Iranian side, on which they agreed on two working groups, for Energy and for Trade and Investment (Reissner & Whitlock, 2004). After the meeting of the working group on Energy in 1999, Iran became an observer of the Inogate program, which is one of the EU's regional energy cooperation programs. Iran also became an observer in the TRACECA-east-west land communication program (Commission of the European Communities, 2001). Iran became a member of Traceca, however it is since 2010, due to UN Security Council and EU sanctions, not provided with assistance from this program (Traceca, ND).

The Council adopted a mandate to negotiate a comprehensive trade and cooperation agreement and a political dialogue agreement in 2001. The negotiations started in 2002 and lasted until 2005, when they were stopped due to revelations on Iran's nuclear activities (Council of the European Union, 2012e). An agreement is a normal channel through which the EU develops relations with other countries and trading partners and it would bring a closer cooperation in several sectors such as, science and technology, energy, transport, environment, drugs control, asylum and migration, education and culture and any other area of shared interest. Such an agreement would bring new benefits for Iran not only in the form of a new trading partner but it would also help Iran in achieving its aim of becoming a member of WTO (World Trade Organization) (Council of the European Union, 2009).

Under the Rafsanjani regime, business environment in Iran became friendlier and European companies were ready to invest. However there were many practical obstacles that made business with Iran more difficult such as, overbearing bureaucracy, weak legal system and the absence of a Trade and cooperation agreement. Trade relations became even more difficult under the Ahmadinejad government (Posch, ND). The Commission observes in its first communication on Iran relations in 2001, that Iran`s economy is inefficient, unreformed and centralized. Also the administrative and legal environment for trade and investments was characterized as not transparent and arbitrary (Commission of the European Communities, 2001). This communication was issued in the time of Khatami rule, when Iran`s economy was most open to world market, after Ahmadinejad became the president the situation became even worse.

## 1.2. Sectors of EU-Iran cooperation in trade

Trade with Iran is subject to the EU general import regime, since Iran is not a member of the WTO and there is also no existing bilateral agreement between the EU and Iran. Trade with Iran is currently also subject to sanctions imposed by UN Security Council and EU sanctions regime (Directorate-General for Trade, 2012).

After United Arab Emirates, EU represented second place of Iran`s major import partners and first place of Iran`s major export partners in 2011. Iran`s other top five import partners are: China, Turkey, South Korea. And other among top five export partner are: China, Japan, India and Turkey (European Commission, 2012).

For EU in 2011, Iran is on the 23 place of the major import partners and on the 30 place of the major export partners. Among top five import partners of EU are China, Russia, US, Norway and Switzerland. The main five export partners are: US, China, Switzerland, Russia and Turkey (European Commission, 2012).

One of the main SITC<sup>1</sup> sections of EU's imports from Iran are: *Mineral fuels, lubricants and related materials, Chemicals and related products, Food and live animals, Manufactured goods classified chiefly by material, Crude materials, inedible, except fuels* (European Commission, 2012). In 2011, 5, 98% of all crude oil imports came from Iran, which puts Iran on the sixth place of the EU's main import partners for crude oil (European Commission, 2011). The first place is taken by Russia with 29, 63 % in 2011 (European Commission, 2011), however EU's primary energy supplies may be threatened if a high proportion of imports are concentrated among only few partners. Therefore Iran can play an important role in diversifying the resources (Eurostat, 2012). For EU, the imports from Iran represented 0, 9% of the total share of imports in 2011 (European Commission, 2012). Almost 90% of all EU imports from Iran are oil and related products (Council of the European Union, 2012e).

One of the main SITC sections of EU export to Iran are: *Machinery and transport equipment, Chemicals and related products, Manufactured goods classified chiefly by material, Miscellaneous manufactured articles, Food and live animals, Crude materials, inedible except fuels*. For EU the exports to Iran represented 0, 7% of the total share of exports in 2011 (European Commission, 2012).

The EU trade balance<sup>2</sup> with Iran was estimated on 5 399 million in 2011, which means that the EU exports to Iran were lower than the imports from Iran (European Commission, 2012). By imposing sanctions on Iran, Iran will have problems with losing EU as an important export partner, but also EU will have to search for new markets for import of goods in certain sectors.

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<sup>1</sup> SITC stands for Standard International Trade Classification and is a product classification of the United Nations used for external trade statistics.

<sup>2</sup> *Trade balance* is the difference between a country's imports and its exports. A country has a trade deficit if it imports more than it exports; the opposite scenario is a trade surplus (Investopedia, ND).



### 1.3. Bilateral trade cooperation between Iran and individual EU member states

By country, *Italy, Spain, Greece and Belgium* are the countries that most rely on import of Iranian crude oil (the main sector of EU's imports from Iran) and collectively account for almost 80% of EU's crude oil imports from Iran. In 2010, Belgium accounted for 10%, Greece for 9%, Spain for 25%, Italy for 34%, and other countries for 16% (Institute of Energy Economics Japan, 2012). Before the economic sanctions were imposed, some 500,000 barrels arrived from Iran to Europe every day, with southern European countries consuming most of it. Greece is the most exposed, since it received a third of all its oil imports from Iran, as well Italy with 13 percent of its oil needs (Makanaka, 2012).

*Germany, Italy, United Kingdom and France* are the top EU states trading partners of Iran. *Germany's* exports to Iran are the highest among the top EU states in the time period 2005–2011, and amounted in 2011 for 3,089.7 million euro (Eurostat in The British Iranian Chamber of Commerce, 2011) the percentage of German exports in 2010-11 was 7% of total goods imported to Iran (ECO Trade and Development Bank, 2012). As an importer from Iran, Germany stands on the third place throughout the period 2005–2011 (Eurostat in The British Iranian Chamber of Commerce, 2011). Iranian market is very important for Germany, since they can offer its specialized machinery without competition from the US (Daragahi, 2010), because US prohibits nearly all trade and investments with Iran (US Department of State, 2012). Some of the biggest German companies, such as Siemens, Ferrostaal, BASF, Thyssen Krupp, are successfully doing business with Iran for several years (Dempsey, 2010). In 2011, German export to Iran dropped for 19% comparing with the previous year. The sharp decline in German exports to Iran is the result of the non-conclusion of business contracts as a result of UN and EU economic sanctions (Federal Foreign Office, 2012a).

*Italy* was the second biggest exporter to Iran and the first importer from Iran in the years 2005–2011. In 2011, they imported for 5327 million from Iran, which is far more than the other three leading countries, on the second place is France with only 1747 million (Eurostat in The British Iranian Chamber of Commerce, 2011). The trade between Iran and

Italy is based on materials used for infrastructure, industry and energy, but the largest part of Italian export to Iran is machinery (Fidler & Stevens, 2010). In 2010, Italian exports to Iran even increased, in the engineering economic sector the exports rose 50%. The Federation of Italian Association of Mechanical and Engineering Industries reported that robotics field increased its exports to Iran by 384%, the steam turbines export increased 236% and thermic machines imports grew by 106% (Meotti & Wienthal, 2011). Major Italian companies, such as Eni, Edison International, have an established cooperation with Iran. Eni, a major Italian gas company, is operating in Iran since 1950s (Fidler & Stevens, 2010). It has signed a 550 million deal with the National Iranian Oil Company in 2001, to develop in cooperation with them the Darkhovin oilfield (BBC Monitoring, 2009). Edison International, another big Italian company signed an Exploration and Development contract with National Iranian oil Company in 2008 for Dayyer oil field (Oilvoice, 2010). Over the decades, Iran has given Italian oil companies access to developing some of its largest oil fields (Fidler & Stevens, 2010).

*France* was, in 2011, the third largest exporter to Iran and the second largest importer from Iran (Eurostat in The British Iranian Chamber of Commerce, 2011). 55% of French exports to Iran are coming from the automotive sector and other sectors such as hydrocarbon sector, rail and shipping transport and the financial sector. French imports from Iran are mostly crude oil (French Ministry of Foreign Affairs, 2007). *A reciprocal agreement to encourage and protect investments* was signed in May 2003, was aimed to establish a more favorable legal framework for companies (French Ministry of Foreign Affairs, 2004). Several major countries are present and doing business in Iran, such as: Total group, Renault, Alcatel, PSA Peugeot Citroën (Daragahi, 2004). Renault is the second most prolific foreign automaker in Iran, and is highly active in the Iranian auto industry as well as has established partnership with regime-controlled entities (Business Wire, 2012). PSA Peugeot Citroën has made a licensing agreement with an Iranian company Iran-Khodro, for the production of Peugeot 206 and 207 in Iran. 60% of the car parts should be manufactured locally (Iran Tracker, 2010). The Total group, one of the largest energy concerns, formed in 2004 a \$ 2 billion venture with the National Iranian Oil Corporation and Petronas of Malaysia, Pars LGN, which aims to produce 8 million metric tons of liquefied natural gas a

year, equal to about 15 percent of current world output (Daragahi, 2004). Involved on the South Pars project are also two other major European companies, Royal Dutch Shell and Repsol YPF, which have made a \$ 10 billion deal to produce 16 million tones/year of liquefied natural gas (LNG) (Watkins, 2007).

*United Kingdom* was in 2011, the fourth largest importer and exporter among EU countries (Eurostat in The British Iranian Chamber of Commerce, 2011). There is an established British Iranian chamber of commerce, to promote trade among the two countries (The British Iranian Chamber of Commerce, ND). In 1994, the British-Iranian business association was established, to provide a forum for British-Iranian business (British Iranian Business Association, ND). One of the biggest oil companies, Shell was ranked as Iran's biggest corporate client, along with French Total group. They have established a long-lasting relationship with Iran through their work in Iran's oilfield and years of crude oil purchases (Mably & Mackey, 2012).

#### 1.4. EU economic sanctions on Iran

##### — Pressure from the US

The use of sanctions against Iran has enjoyed much less support from the EU than it has from US. The use of sanctions against Iran was for the US somehow challenging, since there were already so many US restrictions in place against Iran. Therefore US imposed financial sanctions that sought to deny Iran's access to international business sector, by exploring the advantage deriving from US being the world's leading financial centre (Taylor 2010, p. 68). Iran Sanctions Act was imposed by US to try to deny Iran the resources for the further development of its nuclear program and deny the support to terrorist organizations. The act authorizes US penalties against foreign firms which do business with Iran (Katzman, 2011). The target of the US approach were, besides Iranian companies, those foreign companies, especially banks, who were supporting exports or processing dollar transactions for Iranian banks. The US was trying to convince companies and government officials to stop doing business with Iran. The greatest concern for the

companies doing business with Iran was losing the access to US market because of such activities. The German Siemens faced the threat of losing \$300 million worth of contracts with the Los Angeles Metropolitan Transportation Authority on the grounds that it sold equipment to the Iranian regime which was used to conduct surveillance on dissidents (Taylor, 2010, pp. 68–73). US unilateral sanctions against Iran, caused differences of opinion between the US and EU because they mandate US imposition of sanctions on foreign firms. EU has strictly opposed such unilateral sanctions with extraterritorial effects because they can threaten the open international trading system. EU has even adopted a Blocking Statute to prevent any EU company from complying with Iran sanctions act imposed by US (Patten, 2001).

When adopting sanctions against Iran in 2012, EU was under constant pressure from US, who wanted the EU to adopt such sanctions even sooner. They were pressuring EU to move faster in isolating Iran's financial sector (Norman, 2012).

#### — EU diplomatic measures

EU suspended formal talks on trade and cooperation with Iran in June 2003, because of high concern over the nature of Iran's nuclear program. In order to negotiate with Iran the three EU states, France, UK and Germany formed together the E3 group (Kile, 2005, p. 108). Russia, China and US joined in 2006 the three EU states and together they formed the P5+1 (Davenport, 2012a). The formation of E3 to negotiate the solution to the Iranian nuclear problem reflects the traditional EU preference for the use of incentives over sanctions (Taylor, 2010, 74).

First the E3, and later P5+1 group offered Iran several proposals to resolve the nuclear issue. Iran has made a suspension agreement with the E3 in 2004, and agreed to temporary stop the uranium enrichment process and signed the Additional Protocol to the Safeguards Agreement. This success by the E3 has ended in 2005, when Iran stopped the voluntary implementation of the Additional protocol and continued with uranium enrichment (Nikou, ND). P5+1 offered Iran in 2006 comprehensive negotiations and prepared several

proposals, which Iran once again refused. The comprehensive negotiations were again offered to Iran in 2008 and also this time there were no conclusions made (American Foreign Policy Project, 2009). The proposals were in a new form offered to Iran once again in 2008. A consensus was reached on a draft agreement, but Iran finally resigned due to domestic opposition in 2009 (Nikou, ND). New rounds of talks were organized in 2012 in Istanbul, Baghdad and Moscow, however the only agreement that was reached was on expert-level talks (Davenport, 2012a).

#### — EU economic sanctions

The position of EU begun to change in 2005, when clear evidence regarding the existence of Iranian nuclear weapon program appeared (Taylor, 2010, pp. 74). EU has adopted, as a response to UN Resolutions, several Positions, Decisions and Regulations that impose sanctions determined by the Security Council and also added their own measures (Iran Watch, ND).

There were some differences among the 27 members of EU when it came to sanctions against Iran. UK and France have favored the imposition of sanctions and Austria, Germany, Italy, Spain, (Taylor, 2010, 78) Cyprus and Greece on the other side opposed the sanctions (Baker, 2009). France and UK both made proposals for additional sanctions against Iran and were supporting the US efforts to impose EU sanctions against both Bank Melli and Bank Saderat. Germany on the other side, was the main country opposing sanctions, since it is Iran`s leading European trading partner and Iran is a major market for German industrial and technological products (Taylor, 2010, 78–79).

The Council adopted its first Common Position in February 2007 in order to implement the UN Security Council Resolution 1737, and they also added additional sanctions measures, such as additional persons and entities that would be subject to asset freeze (Council of the European Union, 2007a). In April 2007, Council issued the second Common Position in order to, besides the already implemented measures of Resolution 1737, implement the sanctions determined in the UN Security Council Resolution 1747. Again EU added its

own restrictions (Council of the European Union, 2007b), they imposed a more comprehensive arms embargo and again added additional persons and entities to travel restrictions (Taylor, 2010, p. 76). In August 2008, the Council adopted a Common Position as a response to UN Security Council Resolution 1803, again using stronger measures than the UN imposed by adding additional persons and entities to be covered by the restrictions on admission and the freezing of funds (Council of the European Union, 2008). On July 26, 2010, the Council adopted a Decision which implemented the UN Security Council Resolution 1929, as well as all the previous Resolutions, and again added its own accompanying measures on the areas of trade, financial sector, transport sector and oil and gas industry (Council of the European Union, 2010). However this time the EU unilateral measures were much stricter and broader than in its previous Decisions. The Council has throughout 2011 in May, October and December, adopted three Decisions which have added additional persons and entities included in the list of persons and entities subject to restrictive measures (Council of the European Union, 2011a, 2011b, 2011c).

Further lack of engagement from the Iranian side made EU decide, at the end of 2011, to extend sanctions regime. Therefore in January 2012, the Council decided to broaden the existing sanctions adopted in the previous documents, and added in its new, unilateral Decision with measures that severely affected Iranian financial system, transport sector, energy sector, and measures against Iranian Revolutionary Guard Corps (Council of the European Union, 2012a). In March 2012, Council issued another Decision, further amended the sanctions by imposing targeted financial measures against the providers of specialized messaging services (Council of the European Union, 2012b). Further and more extended sanctions were imposed with the Council Decision in October 2012 on trade, financial sector, oil tankers construction, and they also included new persons and entities on the list of travel ban and assets freeze (Council of the European Union, 2012c). The last set of sanctions was imposed in December 2012 with the Council Decision, which once again amended the previous Decision with provisions on monitoring the activities between the EU and Iran financial institutions, as well as added additional persons and entities on the list of travel ban and asset freeze (Council of the European Union, 2012d).

— Implementation of EU restrictive measures on Iran

The measures taken by the EU in Council Decision 2010/413/CFSP, and in all the following Decisions amending this Decision consist in:

— *Export and Import Restrictions*

Prohibition on trade of items, materials, equipment, goods and technology contained in the Nuclear Suppliers Group and Missile Technology Control Regime lists; arms and related materiel of all types, including weapons and ammunition, military vehicles and equipment, para-military equipment and spare parts for such arms and related materiel, as well as equipment which might be used for internal repression; other dual-use goods and technology (Article 1 (1)).

It is also prohibited to provide technical assistance or training, investment, or brokering services related to items, materials, equipment, goods and technology as well as provide financing or financial assistance related to items and technologies that could contribute to Iran's nuclear enrichment and weapons development (Article 1 (3)).

The direct or indirect supply, sale or transfer to, or for use in, or the benefit of Iran, by nationals of Member States or through the territories of Member States of items, materials, equipment, goods and technology, including software that could contribute to nuclear enrichment and weapons development, shall be subject to authorization on a case-by-case basis by the competent authorities of the exporting Member State. (Article 2)

The import, purchase or transport of Iranian **crude oil** and petroleum products shall be prohibited (article 3a). The execution of contracts concluded before 23 January 2012 on Iranian crude oil and petroleum products can be done until 1 July 2012 (Article 3c).

The import, purchase or transport of Iranian **petro-chemical products** shall be prohibited (article 3b). The execution of contracts concluded before 23 January 2012 on the supply of petrochemical products, can be done until 1 July 2012 (Article 3d).

The import, purchase or transport of Iranian **natural gas** shall be prohibited (article 3e).

The Decision prohibits Member States to provide financing and financial assistance as well as insurance and reinsurance, related to crude oil, petro-chemical products and natural gas to Iran (Article 3e).

The sale, supply or transfer of key **equipment and technology for the petrochemical industry** in Iran by nationals of Member States is prohibited (article 4a). Any obligation relating to the delivery of goods provided for in contracts concluded before 26 July 2010 or October 2012 must be executed until 15 April 2013 (Article 4b).

The sale, supply or transfer to Iran of **graphite, and raw or semi-finished metals**, such as aluminum and steel, relevant to industries controlled by the Iranian Revolutionary Guard Corps or which are relevant to Iran's nuclear, military and ballistic missile program, by Member States shall be prohibited (article 4e). Execution of contracts concluded before 16 October 2012 can be executed until 15 April 2013 (Article 4f).

The sale, supply or transfer of key **naval equipment** and technology for ship-building, maintenance or refit, to Iran or to Iranian or Iranian-owned enterprises engaged in this sector, by Member States, shall be prohibited. (Article 4g). Execution of contracts concluded before 16 October 2012 can be executed until 15 April 2013 (Article 4h).

The sale, supply or transfer to Iran of **software** for integrating industrial processes, which is relevant to industries controlled directly or indirectly by the Iranian Revolutionary Guard Corps or which is relevant to Iran's nuclear, military and ballistic missile program, by Member States, shall be prohibited (Article 4i). Execution of contracts concluded before 16 October 2012 can be executed until 15 April 2013 (Article 4j).



The Decision also prohibits Member States to provide Iran with technical assistance or training and other services or financing or financial assistance related to equipment and technology for the *petrochemical industry, graphite, and raw or semi-finished metals, naval equipment, naval equipment, software for integrating industrial processes*.

The direct or indirect sale, purchase, transportation or brokering of gold and precious metals, as well as of diamonds, to, from or for Iran is prohibited (Article 4c).

The delivery of newly printed or minted or unissued Iranian denominated banknotes and coinage to or for the benefit of the Central Bank of Iran shall be prohibited (Article 4d).

— *Restrictions on Financing of certain enterprises*

Investment in the territories under the jurisdiction of Member States by Iran in any commercial activity involving uranium mining, production or use of nuclear materials and technology, in particular uranium enrichment and reprocessing activities, all heavy-water related activities or technologies related to ballistic missiles capable of delivering nuclear weapons, shall be prohibited (Article 5).

It is prohibited the *granting of any financial loan or credit and the acquisition or extension of a participation* in enterprises in Iran that are engaged in the Iranian petro-chemical industry, or to Iranian or Iranian-owned enterprises engaged in that industry outside Iran; the *creation of any joint venture* with enterprises in Iran that are engaged in the Iranian petrochemical industry (Article 6a).

— *Restrictions on financial support for Trade*

Member States shall exercise restraint in entering into new short term commitments for public and private provided financial support for trade with Iran, including the granting of export credits, guarantees or insurance, to their nationals or entities involved in such trade;

Member States shall not enter into new medium and long-term commitments for public and private provided financial support for trade with Iran (Article 8).

The construction or the participation in the construction of new oil tankers for Iran or for Iranian persons and entities shall be prohibited (Article 8a).

It shall be prohibited to provide technical assistance or financing or financial assistance to the construction of new oil tankers for Iran or for Iranian persons and entities (Article 8a).

— *Financial Sector*

Member States shall not enter into new commitments for grants, financial assistance and concessional loans to the Government of Iran (Article 9).

Member States shall not enter into any transactions with: banks domiciled in Iran, in particular the Central Bank of Iran; branches and subsidiaries of banks domiciled in Iran whether within or outside the jurisdiction of the Member States; financial entities that are not domiciled in Iran, but are controlled by persons and entities domiciled in Iran. Unless authorized by a Member State (Article 10(1)).

Certain transactions are permitted, however they must be authorized in advance. Such transactions include: transactions regarding foodstuffs, healthcare, medical equipment, or for agricultural or humanitarian purposes; transactions regarding personal remittances; transactions regarding the execution of the exemptions provided for in this Decision; transactions for a specific trade contract; transactions regarding a diplomatic or consular mission or an international organization enjoying immunities; transactions regarding payment to satisfy claims against Iran (Article 10(2)).

The transfers of funds in sectors that are permitted face certain limitations regarding the amount of the transfer; Authorization by a member state is needed when: transactions regarding foodstuffs, healthcare, medical equipment, or for agricultural or humanitarian

purposes are above 100 000 EUR; transactions regarding personal remittances are above 40 000 EUR (Article 10 (3)).

Financial institutions shall be required, in their activities with banks and financial institutions to: exercise continuous vigilance over account activity including through their programs on customer due diligence and under their obligations relating to money-laundering and financing of terrorism; require that all information fields of payment instructions which relate to the originator and bene-ficiary of the transaction in question be completed; maintain all records of transactions for a period of five years (Article 10(3a)).

The opening of new branches, subsidiaries, or representative offices of Iranian banks in the territories of Member States, and the establishment of new joint ventures, or the taking of an ownership interest, or the establishment of new correspondent banking relationships by Iranian banks, including the Central Bank of Iran, its branches and subsidiaries is prohibited (Article 11).

Financial institutions within the territories of Member States or under their jurisdiction shall be prohibited from opening representative offices, subsidiaries or banking accounts in Iran (Article 11).

The provision of insurance and re-insurance to Iran shall be prohibited (Article 12).

The direct or indirect sale or purchase of, or brokering or assistance in the issuance of public or public-guaranteed bonds issued after the entry into force of this Decision to and from Iran, the Central Bank of Iran, or banks domiciled in Iran shall be prohibited (Article 13).

Member States shall require their nationals, persons subject to their jurisdiction and firms incorporated in their territories or subject to their jurisdiction to exercise vigilance when doing business with entities incorporated in Iran including those of the Iranian

Revolutionary Guard Corps and of the Islamic Republic of Iran Shipping Lines (Article 14).

— *Transport Sector*

Member States shall inspect all cargo to and from Iran in their territories, including seaports and airports, if they have information that provides reasonable grounds to believe that the cargo contains items the supply, sale, transfer or export of which is prohibited (Article 15(1)).

Member States may request inspections of vessels on the high seas with the consent of the flag State, if they have information that provides reasonable grounds to believe that the vessels carry items the supply, sale, transfer or export of which is prohibited (Article 15 (2)).

Aircrafts and vessels transporting cargo to and from Iran shall be subject to the requirement of additional pre-arrival or pre-departure information for all goods brought into or out of a Member State (Article 15 (4)).

Member States shall seize and dispose of items the supply, sale, transfer or export of which is prohibited (Article 15(5)).

Member States shall report about any information available on transfers or activity by Iran's Air's cargo division or vessels owned or operated by the IRISL to other companies (Article 16).

Member States shall take the necessary measures to prevent access to the airports under their jurisdiction of all cargo flights operated by Iranian carriers or originating from Iran with the exception of mixed passenger and cargo flights (Article 17).

The provision by nationals of Member States, of engineering and maintenance services to Iranian cargo aircraft shall be prohibited if there is information indicating that the cargo aircraft carry items the supply, sale, transfer or export of which is prohibited (Article 18).

— *Restrictions on Admission*

Member States should prevent the entry into or transit through their territories of persons providing support for Iran's proliferation-sensitive nuclear activities or for the development of nuclear weapon delivery systems, for instance by acquiring prohibited goods and technology or by assisting listed persons or entities in violating UN and EU provisions; and other members of the IRGC (Article 19).

Currently such restrictions apply to 105 persons, 43 of them have been designated by the UN, and the others are autonomous EU designations. Those individuals are also subject to an asset freeze (Council of the European Union, 2013).

— *Freezing of Funds and Economic Resources*

All funds and economic resources which belong to entities and persons associated with associated with Iran's proliferation-sensitive nuclear activities or the development of nuclear weapon delivery systems, for instance by acquiring prohibited goods and technology or by assisting listed persons or entities in violating UN and EU provisions; and senior members and entities of IRGC and the IRISL. This includes the Central Bank of Iran (Council of the European Union, 2013).

Currently such freezing of funds and economic resources amounts to 490, including the Iranian central Bank. 76 of them were designated by UN and others are autonomous EU designations. They include companies the banking and insurance sectors, the nuclear technology industry and in the field of aviation, armament, electronics, shipping, chemical industry, metallurgy and the oil and gas industry as well as branches and subsidiaries of IRGC and IRISL (Council of the European Union, 2013).

## 2. Critical Analysis

### 2.1. Assessment of efficiency of economic sanctions and its impact on Iran

Assessment of efficiency will be made based on the political and economic variables determined in Chapter 1.

#### 2.1.1. Political variables

##### — Companion Policy measures

Measures used by the EU were first diplomatic, basing on the negotiations and propositions to the Iranian government. After there was no success the EU decided to take further measures which were economic sanctions and these are the last and the strictest form of sanctions imposed. Since the EU has a preference for soft measures, as it has already shown in the resistance to sanctions imposed by the US, there is little possibility that there will be a use of covert action, quasi-military action or regular military action.

##### — International cooperation

International cooperation with EU economic sanctions is most crucial from the countries that are big trade partners of Iran. Among the great trade partners of Iran that are supporting EU measures are: *Japan, Turkey, UAE, South Korea and US*.

*Japan* was, in 2010, the third main exporting market for Iran (European Commission, 2012). It has been slowly decreasing its imports of Iranian oil ever since the 2006 sanctions took effect, and has reduced it by roughly 40 percent. Over the last several years, Japan is one of the closest partners of EU and US in international cooperation for the sanctioning of Iran's nuclear program (Smith, 2012). The main problem for Japan is the energy security situation and the longstanding dependence on Iranian oil, which can explain the reason why

the Japanese government has not played a leading role in the sanctions against Iran (Taylor, 2010, 82).

*Turkey* stands somewhere in the middle between the EU and Iran. Turkey is heavily dependent on Iranian crude oil and has therefore, in 2010, voted against sanctions on Iran in the UN Security Council (Taspinar, 2012). However it does in the recent years represent a key ally of EU in the region. Turkey has cooperated with the sanctions imposed by the EU and US to a certain degree, they have decided to cut oil imports from Iran for 20% in 2012 (Dombey, 2012), which is an important step. On the other side Turkey represents the main channel for Iran`s trade with Europe. Since Turkey is a preferred trade partner of the EU and Iranians do not need a visa to enter this state, Iran can buy goods from Europe through Turkey (Lipshiz, 2012).

The *UAE* have also been supportive to sanctions on Iran. They have implemented all the UN Security Council sanctions and shut down several companies in Iran (Shaheen, 2010). The biggest change in trade with Iran has occurred in Dubai, which is the leading trade center of UAE. Changes in this confederation are crucial since they represent Iran`s major import partner and an important connection with the rest of the world (Rosenberg, 2011).

*South Korea* has also shown support for the EU sanction on Iran. It was the first one of the major importers (besides India, China and Japan) of crude oil from Iran to announce it will give up supplies (RT, 2012a). South Korea halted imports of Iranian crude oil in beginning of July 2012 as a response to EU sanctions. It has been able to do so by increasing import from other Middle East nations (Stangarone, 2012).

The most crucial international support comes from the *US*. US has been the initiator of sanctions against Iran. Although US is not amongst the important trade partner of Iran, since it has limited its relations with Iran to almost none, it is an important superpower that has a lot of influence on the behavior of the whole international community. As already mentioned, US has imposed Iranian Sanctions Act, which has extraterritorial effects,

sanctioning all the companies that make business with Iran, therefore influencing the whole international community (Patten, 2001).

— International Assistance to the Target Country

Like the EU, also Iran has its allies that help opposing the sanctions and giving support with opening its markets to Iran. The most significant and important allies are for sure *China* and *Russia*. Russia, although not such a large trading partner of Iran, has an important role because of its permanent seat in the Security Council.

Both China and Russia have, like the EU, preferred the use of incentives over sanctions and a diplomatic approach when it came to Iranian nuclear program. However when incentives had no impact they were not willing to take a further step. Russia's support mainly depends on its energy consideration, such as the assurance that its companies have the leading position when it comes to commercial opportunities in Iranian energy sector (Taylor, 2010, 86). China as the second largest importer from Iran, mostly of crude oil as such does not want to participate in the oil embargo (Mao & Blanchard, 2012). The second reason for the opposition to sanctions are the growing economic ties with Iran in the recent years, which show that China is benefiting from the withdrawal of Western companies in Iran (AFP, 2012).

*India* is the next country opposing sanctions on Iran. As the second biggest importer of Iran's oil, it has shown reluctance to sanctions imposed on Iran, and it has, similar like China prospered from the absence of western companies in Iran. India pays its oil imports from Iran with wheat, which does not contribute to the nuclear program (Lakshmanan & Narayanan, 2012). India imported 70% of oil consumed, and 10% comes from Iran, therefore immediate cut of trade with Iran is certainly not in its interest (Cheema, 2012).

*Venezuela*, although not a major trade partner, is yet another important country supporting Iran. The friendship between Venezuela and Iran has started to grow stronger when the sanctions were imposed. Both countries have similar interests in opposing the West and



US. Their bilateral trade exceeds \$ 40 billion, and Iran has reportedly entered into more than 150 energy development, commercial and financial agreements with Venezuela (Baitel, 2012). However the most worrying are not the trade relations among these two countries, but the military cooperation they are establishing. Venezuela's president Chavez has allowed the Iranians to use Venezuelan territory to mine for uranium, they have also offered assistance Iran in development of nuclear technology and in evading UN sanctions (Suchlicki, 2012).

*Pakistan* is Iran's neighbor, and their support is especially relevant for Iran. Pakistan has expressed its opposition toward EU sanctions and showed interest in expanding bilateral relations with Iran (Teheran Times, 2012). The country has also emphasized the necessity for boosting trade among the D8 (Shia News Association, 2013). D8 is an organization of eight developing countries, Iran, Turkey, Malaysia, Pakistan, Nigeria, Egypt, Bangladesh and Indonesia, that was established for the purpose of economic cooperation among these countries (D8 Organization for Economic Cooperation, ND). This group represents important channels for Iranian trade when facing EU sanctions.

#### — Prior Relations between Sender and Target Country

In order to determine the degree of sanctions, we need to evaluate the relations between Iran and EU before the conflict. As already analyzed in Chapter III subchapter 1, the relations were developing well before the conflict. They started to form a Dialogue in 1995 and continued with setting up working groups for Energy as well as for Trade and Investment, in 1999 Iran became an observer of the Inogate program and a member of TRACECA program, they even started to negotiate a comprehensive trade and cooperation agreement and a political dialogue agreement in 2001. However all of this stopped in 2005, due to the problems with Iran's nuclear program. Based on this information, we can evaluate the relationship between the two countries as *neutral*. They were not close allies, however there was a workable relationship that was moving toward a cooperation before the problems appeared.

## — Political Regime of the Target Country

There are several indicators that show the nature of the political regime of the target country. As stated, Iran has a theocratic political system. I will try to revise the main characteristics that show why Iran has such a system.

When analyzing the *institutionalized competitiveness of political participation*, we need to see what are the possibilities for alternative preferences for policy and leadership in the political arena (Gurr, Marshall & Jagers, 2011). In Iran we have a clear separation of the left, the right and the center that compete for the seats in the Parliament and that represent their candidates for the election of president. However there are certain repressions of competition that are present in the political arena. As mentioned before, in 1996 parliamentary elections the Guardian Council banned the participation of nearly all of the left coalition members, in 2005 the Guardian Council again made a strict prohibition that prohibited women to run for president. All of these regulations were made in the benefit of the right coalition that has the support of the Guardian Council. Since the Guardian Council is the body that supervises the national elections, its behavior should certainly be less subjective. On the presidential election in 2005 as well as 2009, when Ahmadinejad won, there was a clear violation when it came to counting the votes. Again the main involved in these violations were the Guardian Council and also the Revolutionary Guard Corps that took the right to design its own results and ignore the right of popular vote.

The second indicator is the *regulation of political participation*, and we can say that in Iran this is established to a certain degree. There is one identity group that secures central power and restricts other competing groups the political activities, until it is displaced in turn (Gurr, Marshall & Jagers, 2011). We can see that there are several political groups in Iran, the right, the left and the centre. Currently the right is ruling the country, with president Ahmadinejad taking different illegal measures to keep the right on the leading position in the country.

The *openness and competitiveness of executive recruitment* can be defined as almost closed in Iran. The chief executive in Iran is the Supreme Leader, and he is appointed by the Assembly of Experts. As such he represents a Caesaristic leader which attempts to establish the principle of hereditary succession (Gurr, Marshall & Jagers, 2011). Explained differently there is not a system that gives equal chances to several candidates that would run for this position, once the Supreme leader is appointed it is usually for a lifetime mandate without termination, unless the Assembly dismisses him.

The *institutional constraints on the exercise of the executive power*, are referring to the extent of institutional constraint on the decision making power of the chief executives (Gurr, Marshall & Jagers, 2011). In Iran the chief executives are the Supreme leader, the President and the Council of Ministers. The supervisory organs are the Assembly of Experts, the Expediency Council and the Guardian Council. Although there is a formally established supervision over decision making of executive branch, the Guardian Council sides with the conservative right and therefore supports and works together with the Supreme leader as well as with the President. The Expediency Council was set up to reduce the power of conservatives in the Guardian Council, but since the members are appointed by the Supreme leader that also sides with conservatives, it is questionable how objective is their role. In the same way the Assembly of Experts is an elected body, however again the Guardian Council has to approve all the candidates.

#### 2.1.2. Economic variables

— The size of the sender and target country

The relative size and GDP of the sender is usually bigger than the one from the target. The sender, in our case the EU, had in 2011 a GDP of \$ 15, 48 trillion (CIA, 2013) as the target country, in our case Iran, had in 2011 a GDP of \$990, 8 billion (CIA, 2012). By the size the difference is also big, size the EU is 4, 324, 782 sq km and is less than one half size of the US (CIA, 2013) and on the other side Iran as the 18 largest country in the world with 1, 648, 195 sq km (CIA, 2012).

—The trade linkages

Sender country is usually a very large trade partner, as it is also in our case. As already mentioned, EU is an important import and export partner of Iran, and the termination of trade does leave consequences for Iran. EU was the second major importer and the first export partner of Iran in 2011.

— The types of sanctions used

The type of sanctions that the EU used were economic sanctions, more specific they used trade sanction, financial sanctions and asset freezes. EU and UN also used the new concept in economic sanction, called smart sanctions, by using asset freeze and travel bans for entities and individual connected with the illegal nuclear activities in Iran, and this way they targeted sanctions in order not to influence the innocent. The sanctions imposed were in certain measures unilateral and in certain multilateral. EU has imposed sanctions by UN Security Council that are multilateral as well as imposed additional measures that are its own decision and imply only to trade between EU and Iran. If talking about the type of sanctions we can also say that the sanctions imposed are negative sanctions, since they include measures such as embargo, boycott, blacklist, freezing assets.

— The economic health and political stability of target country

*Economic health* in Iran has been throughout the history a problematic factor in the country. In Rafsanjani period, in Khatami period and especially in Ahmadinejad period economic problems disrupt the functioning of the state. The main problem is the high dependency on oil. As already mentioned 80% of Iran`s foreign income comes from trade and the rest comes from taxes. This makes their economy very dependent on the prices of oil as well as o the trade partners that buy oil. The second problem is the high inflation that the state is facing. As Ahmadinejad decided to block foreign investments and impose isolationist measures, as well as started uncontrolled spending, the consequences were a

high inflation. Iran also experiences chronic unemployment, since the unemployment rate between 1987 and 2010 averaged on 13 percent (Grammy, 2011). The *political stability* can according to the economic situation also be questionable. Although the right coalition has a very strong position in the country, having a majority in most the state bodies, the economic situation in the country brings great discontent among the people. The Ahmadinejad regime is known by its repression and hard rule, therefore there is probably fear of rebellion, however when the situation gets extremely bad the country is known by its big protests, such as in the time of revolution.

Therefore the evaluation of the economic health and political stability in the country according to the scale introduced in the first chapter is that the country has *significant problems*, since it has severe economic problems, as well as substantial internal dissent.

— The estimating costs of sanctions to the target country

In Chapter II, we mentioned that the main problem of Iran`s GDP is the high dependence on oil and very low non-oil growth. The costs that were caused by EU sanctions to Iran will be measured with the change in its GDP. Due to the drop in trade, GDP has been estimated to decrease, according to IMF, 0, 9% in 2012 (Policy Analysis Unit, 2012). According to Economist Intelligence Unit, it is estimated a drop of GDP for 1, 2% further on in 2013 (Cordesman *et. al*, 2012). Since the last value of Iran`s GDP, in 2011, has been estimated on \$ 474, 7 billion (CIA, 2012), we can estimate that the drop and therefore also the cost of sanctions for Iran will be, in 2012, approximately \$ 4, 46 billion and possibly in 2013 it can rise up to approximately \$ 5, 95 billion. A challenging financial consequence of sanctions is also high inflation, the national currency has lost 40 percent of its value against dollar (Kanter, 2012).

### 2.1.3. Assessment of efficiency of sanctions

The goal of the imposed sanctions was to *impair the target country`s military potential*. According to the analyses of variables we can evaluate if the political and economic costs

to Iran from sanctions are greater than the political and security costs of complying with the EU's demands. It means that the costs for the target country have to be greater if it defies sanctions than if it complies with them, in order for sanctions to be efficient (Hufbauer *et al.*, 2009, 50).

The *political costs* that the sanctions bring to Iran, can according to the variables be the loss of good relations with certain important states such as Japan, UAE, South Korea and to some amount also Turkey. The political costs are also the lost relations with EU that were developing toward a trade and cooperation agreement. However since Iran is a theocracy and is ruled by conservatives as well as by a radical president, who both have an interest for militarization of Iranian nuclear program, perhaps losing good political relations is not the main concern of the country. They have on their side two very important countries such as China and Russia that have a similar view on the nuclear weapons, and that have a lot of influence on the decisions in the Security Council. Such partnerships give Iran a lot of incentives for a further development of their nuclear weapons program. Economic sanctions can never be universal, since there are always countries that side with the target. There is also no fear that EU would use companion policy measures that would cause political or security costs to Iran. As an old advocate of diplomacy over sanctions, it has changed its stand a bit by imposing economic sanctions after several diplomatic attempts failed. However it is not in the interest or the nature of EU to use any military measures with the country such as Iran, because it would bring further risks that could endanger the whole international community. The only country that could perhaps persuade them in cooperating in such measures would be the US.

First one of *economic costs* for the sender would be the loss of the trade linkages. They had a very well developed trade among EU and Iran and among individual members of EU and Iran. EU certainly is a large market of 27 states that is hard to replace, however as already mentioned there are other countries willing to work with Iran such as Pakistan, that has in 2012 signed a deal to supply wheat to Iran in exchange for electricity and petroleum products (Hussain, 2012); such as Turkey, who supposedly cooperates with EU, however also became third largest trade partner in 2012 (Press TV, 2012b); and others who are not

intimidated by EU sanctions and US extraterritorial sanctions, or those who find other channels of trade with Iran. The type of sanctions that were used by the EU, the economic sanctions, are not really efficient for a system where the elites rule the country and don't provide much for the citizens. Although EU imposed smart sanctions that target the members of elites and their fortune, the other part of sanctions that bans the trade in certain sectors of goods influences on the whole economy in Iran and therefore also the innocent people that have to face consequential high unemployment and inflation. Economic health has been a problem of Iran for decades however it has managed to cope without any foreign help or intervention. Therefore it is questionable how much will some economic damage caused by the sanctions really affect them since this is something they are used to dealing with. There are also observers that state, the economic problems are not only the consequence of economic sanctions but mostly the result of Ahmadinejad economic policies (Arab Center for Research & Policy Studies, 2012). Iran can, as already mentioned, certainly find other trade partners that will improve the economic health of the country. Russia, China and India are all major gold produces, and in case trading with currencies get's too complicated it can be replaced with trading oil for gold, which has always represented a good alternative for money (Katusa, 2012). As for the political stability, there is a very strong position of the right coalition in the country that rule with a strict hand over the people. This is a country that formally has an elected president, and in reality it has arranged elections that are controlled by the elite of the country. The stability of these elite is perhaps too strong to be changed by the protests and discontent of the ordinary people. The protests that have emerged so far were not on a scale large enough to threaten the stability of regime, which could be the evidence of the unwillingness of the Iranian people to engage in another protest, as well as disappointment that the protests have brought in 2009, after the reelection of Ahmadinejad (Arab Center for Research & Policy Studies, 2012). The costs that are caused to Iran by imposing sanctions are certainly high, and already do and will cause trouble. However the sectors that are sanctioned, such as crude oil, petrochemical products, natural gas, are all goods that are highly needed in the world, and there will always be a country that will be willing to take the risk and buy the goods from Iran, possibly getting them at a lower price considering Iran's situation. Iran also finds

other paths to trade with Europe, such as through Turkey, which is certainly not in favor of EU.

The *security costs* for Iran, if it would comply with the demands, are the greatest since it means a loss of a nuclear weapons program which would potentially take away the chance of becoming the leading country in the region. The security dimension is the main reason why Iran refuses to comply with the demands of EU. It's main opponents such as the US and Israel possess a nuclear weapon, as well as allies such as Pakistan, North Korea, India, China, Russia (Kimball, 2012), therefore it is difficult to expect that Iran would give up its opportunity to build one itself and not become a member of the nuclear club. The resistance to all the sanctions shows that it is their main priority to develop a nuclear weapon.

Basing on the variables analyzed we can conclude that complying with the EU demands would cause, in Iran's perspective, more costs than non-compliance with them. We can justify this by looking at the main interest of the target country. Iran's main interest has been, ever since they have started a nuclear program, to develop a nuclear weapon. They have covered that from international community because they were aware that most countries would oppose such actions. There have been several attempts and offers that would help Iran economically improve its situation in exchange for the termination of the uranium enrichment program, one of them was for example the offer made by P5+1 that included cooperation in the fields of aviation, telecommunications, high-technology, and agriculture and other areas between Iran, EU and US (Davenport, 2012a). However Iran refused, which clearly indicates its higher interest over their security dimension. Nuclear weapons are a symbol of power which Iran certainly wants, in order to be able to counter the West.

The political and economic costs are not as significant to Iran, which has been seen over numerous negotiations, threats and finally economic sanctions that have been imposed to terminate the illegal nuclear activities in Iran, however without success and efficiency. The main reason for inefficiency of the measures taken is not that the measures were not targeted in the right directions. They were, and they included all the sectors in which EU is



a crucial and important partner for Iran, and that certainly will leave an impact on the country's economy. The main problem lies in the interests of the ruling elite in Iran that does not give up under economic pressures, because their main interest is militarization of their nuclear program with which they could show their power to the international community, and also ensure the state's security against a military attack.

## 2.2. Consequences of economic sanctions for the EU

### — Consequences for individual EU members

From individual members, most affected will certainly be the countries importing most crude oil from Iran. Those are: Greece, Spain and Italy. Those are also the countries that face the greatest economic crises in the EU. Their financial situation might make it difficult to find a new crude oil supplier, since they are not the most reliable in payments due to their financial problems as well as have many other problems they have to solve parallel to this one.

*Greece* is drastically challenged in the EU, by the ban on crude oil trade with Iran. The Hellenic Petroleum refinery, which is the biggest Greek refinery, has been denied crude oil by Iran, due to non-payment because EU banks refused to facilitate payments, as a result of financial sanctions (Payne & Farge, 2012). Finding new trade partners for a country with significant financial trouble could be much harder than making a deal with a long-term trade partner. Iran was the one country that was selling Greece its oil for credit, which means they were able to pay for shipments later. Other oil suppliers want credit drawn from foreign banks, not Greek ones, because of the risk of the latter collapsing. This also means that Greece will have to make a prepayment for oil, which can bring great trouble to cash-flow of refineries due to the large quantities of imported oil per day (Birnbaum, 2012). Iran has, after the EU imposed sanctions in January 2012, threatened to immediately stop crude oil supply to Greece, which is highly dependent on imports from Iran (Birnbaum, 2012). This has brought great psychological pressure and insecurity into a country that already faces major domestic problems. EU was aware of the situation Greece is facing after the

sanctions come into force and has therefore agreed that the cutoff happens later in July 2012. However Iran has, as revenge against EU measures, stooped the crude oil exports to Greece already in April (Karimi, 2012). Since April 2012, Greece had to rely on oil from sources such as Libya, Russia and Iraq (Kent & Gross, 2012). Greece was given the opportunity to replace the imports from Iran, with the imports from Russia and Saudi Arabia. The main problem however is that Greece already imports 46 percent of its supplies from Russia (Athens News, 2012), and a high dependence on crude oil from only one country can again bring new risks, especially if that country is Russia which was already seen as unreliable partner in the 2009 Russian-Ukrainian gas crises, when gas supplies to EU were temporary stopped (Westphal, 2009). There are parts of Greece, such as Kastoria, where people cannot afford to have heating due to the bad economic situation they are facing and the high prices of oil (Staley, 2012). Blocking imports from Iran makes the prices of oil even higher, and the situation for Greek economy even worse than it already is.

*Italy* is the country that was estimated to suffer most from the EU embargo on Iranian oil, as Italy and Iran have always been close business partners as well as because Italy depends heavily on the supplies of crude oil from Iran and because it is heavily affected by the economic crises (Press TV, 2012a). The Italian refineries have made arrangements to import crude oil from Russia, in order to substitute the Iranian supply (Bias, 2012). Contracts with Saudi Arabia are also considered a solution however the problem appears for smaller refineries, since Saudi Arabia wants signing up contracts for fixed periods (Kurahone & Dinati, 2012). Italy is also highly depended on crude oil from Libya, which has recently faced a civil war and is perhaps also not the most reliable partner, since new disputes may emerge and also the prices of oil from Libya remain quite high because of the war. Russia and Saudi Arabia each separately amounted for around 15% of Italian crude oil imports in the first quarter of 2012 (Kovalyova, 2012), which indicates again a high dependence on imports from limited number of countries. As already mentioned, high dependence on only few sources can bring new uncertainties and trouble. Italian companies have a well established presence in Iran, and the sanctions may cause the end of a longstanding trade relations and replacement with Turkish and Chinese companies, that will be happy to gain new trade connections. It has been estimated, that complying with EU

sanctions will cost Italians 30 000 jobs (Press TV, 2012a). This may have very drastic consequences for a country where the unemployment was already high at 11, 2 percent in the end of 2012 (Fontes, 2013). Italian company Edison International had to withdraw from Iran`s contract to explore Iran`s Dayyer natural gas field (Nuland, 2012), which indicates EU sanctions inflict also on research activities, which is certainly not good for future development on energy field. The company Eni has had an established trade relation with Iran ever since 1950s, and they suddenly had to terminate it. People in Italy already face significant economic problems with a weak euro and higher taxes, and the prices of oil that have already raised since sanctions were imposed cause even more problems, especially for citizens dependant on car transport. Experts also warn that if prices of oil in Italy remain so high they could face an inflationary depression (Vassari & Ebhardt, 2012).

*Spain* imports almost all the oil it consumes for its energy and manufacturing sectors. The country has imported great amounts from Libya, however after the civil war it has started to supplement the oil imports from Libya with Iranian crude oil. Therefore sanctions on Iran represent a great threat to the Spanish energy sector, which is 80% dependant on imports (Comas, 2012). Spain is turning to South America for new oil imports. They started to import crude oil from Mexico, Columbia and Venezuela (Davies, 2012). However these new partners represent still a new trade link which has no guarantees for a long-term commitment. Especially Venezuela can be a very unstable partner. Although Spain brings economic benefits for the country, Venezuela also has a very close and strategic relation with Iran, and in case Iran has something against the exports to Spain, Venezuela will certainly be more interested in remaining friendly relations with Iran than keeping Spain as an export country for crude oil. The problem that Spain faces is also the prices of oil, that have started rising even before the sanctions were imposed and have continued to rise even more after the sanctions. If the economic health of the country would be normal, a rise of oil prices would not represent such a problem. However as Spain is close to a second recession, the unemployment is at 22, 8 percent, the rise of the price of oil can represent catastrophic consequences. Spain has reduced the speed limit from 120km/h, to 110km/h, in order to lower the oil costs. Prices may become so high that citizens won`t be able to

afford gas (RT, 2012b). Spain is one of the three countries that have been sacrificed for the sanctions on Iran.

*Belgium* is the fourth EU country most dependant on oil from Iran. However if we look at articles and reports in newspapers and other sources we can notice that there are not many news on bad consequences that Belgium might face due to lack of oil from Iran. At least not as much as about Italy, Greece and Spain. This can tell us that although Belgium might face some consequences, they will be much less obvious as in other three countries due to a much better economic situation in this country. As mentioned before, if a country has good economic health, rise of oil prices does not represent such a significant problem. Since it has a stronger economic position it is also much easier to find new trade partners for crude oil.

There are also several common problems that all EU countries importing oil from Iran have to face. The first fear is that as more countries stop importing oil from Iran, the demand for oil from Saudi Arabia will increase, forcing them to use its spare capacity. After the Libya war, Saudi Arabia made no production response to the loss of Libyan oil. It took them 4-5 months to increase production (McDonald, 2012), which can be concerning for the countries counting on oil from this country. There are not only European countries relying on oil imports from Saudi Arabia, but also Turkey and Japan. The second concern is the Strait of Hormuz, through which all the oil travels to the main importers. Iran has been making constant threats to close it, and block the passing of exports to Asia, EU and US. There are other routes available however this would mean delays and higher costs. Closing the Strait would also cause a high increase in the prices of oil (Tverberg, 2012). The third problem is the fact that oil embargo on Iran has influenced also on the prices of oil. The lack of oil and the insecurity about finding new trade partners pushed prices higher. The prices have grown more than 9 percent for August 2012 delivery, which was the biggest one day oil-rise in percentage terms since 2009 (Press TV, 2012c). The decision to stop dealing with Iran's central bank is also influencing on the rise of prices (Atwi, 2012).

The three countries, UK, France and Germany, are not as much dependant on oil from Iran however they do have a well established economic relations with Iran that suffers. *Germany* export dependant entrepreneurs fear that if they cut ties with Iran, they are out for the next generation, because Malaysian, South Korean and Chinese rivals will take their place on the market. It has already been noticed, that while major firms such as Siemens and Daimler are stepping away from the market, due to pressure from the sanctions, there are their subcontractors and suppliers that are already making side deals with Iranian companies (Daragahi, 2010). The bilateral trade among the two countries dropped for 19 percent in 2011, due to EU sanctions (Federal Foreign Office, 2012b). As mentioned, Iranian market is important for Germany because there is no competition from the US. Loosing such a market, also for a strong country such as Germany, is certainly not positive for its economy in times of economic crises.

*French* auto-manufacturing group Peugeot Citroën had to stop the production in one of its factories in France due to lack of spare parts that are produced in Iran. The consequence was the lay off by 220 workers (Arutz, 2012). This shows what is the direction in which the EU sanctions are leading domestic companies and hurting their production and employment. It influences innocent people in a time of economic crises where many people struggle to keep their jobs. The French Total group is specialized in oil and gas exploration and production also suffers from the lost of Iranian market. Iran as a country with large oil and gas reserves offers many opportunities for investment and research that had to be canceled. Asian countries are likely to take their place, and even if sanctions will be lifted, the opportunities will already be taken.

The *UK* has also been facing a large decrease in trade with Iran and is losing manufacturing and trade relationship. There are small companies that produce widgets that have nothing to do with bombs but they are caught by sanctions, which have caused collapse of several such small companies (Sultan, 2012). The Iranian population is young and there is a high demand for foreign goods, which offers a dynamic market for imports into the country (Global Trade, ND).

## CONCLUSION

In the first part of this dissertation I have researched the effectiveness of EU sanctions on Iran, and the discoveries that this research brought me to, give us several findings. The political and economic variables, which represented a tool for research and helped discover more about the possibility of the efficiency of EU sanctions on Iran, have shown results that enabled me to find the answer to the first hypothesis of this dissertation. Iran is a country with a significant interest in developing a nuclear weapon. The fact that the international community is against such activities and tries to prevent them from having one, makes Iran want it even more. Iran is a loner in the international community and shares common positions only with few other countries. Iran also wants to be competitive with other countries in the military field. They are aware that in the economic sphere they are behind the West, and they probably need much more time to develop a transparent environment for trade. Or perhaps that is not even something they are interested in, since the elites are the ones ruling the country and imposing isolationistic measures. However state economy is not as big a concern as foreign military assets endangering their sovereignty and security as a state. The absence of a nuclear weapon in an environment where their main enemies such as the US and Israel, possess nuclear weapon and constantly threaten with attack, is certainly more disturbing for Iran than its economic condition. Politically and economically it has the support from some big and influential countries, such as China, Russia, Venezuela and India. Economically it will lose some important export markets such as EU, Japan, South Korea, however it will surely find new partners or other channels to do trade. Security costs however would mean the loss of an opportunity to possess a nuclear weapon, which is something a conflicting, individualistic and closed country such as Iran would never settle for.

According to these findings I can accept the first thesis of the dissertation: *The political and economic costs for Iran, caused by EU sanctions will in fact not be greater than the political and security costs of complying with the EU's demands and therefore the sanctions will not be efficient*, is true, since they give such a great importance to their

nuclear weapons program, that additional economic problems can not persuade them to stop it.

In a theocracy, with a president such as Ahmadinejad, that shows no interest in cooperation with international community, is not intimidated by sanctions, and the strict measures don't stop his ambitions to build nuclear weapon, the only solution, according to some experts, that would make sanctions efficient would be the change of incentives and capabilities within the country so that more acceptable leaders can win power (Hufbauer *et al.*, 2009, p. 52). This has shown in the past as very challenging especially because of repression and corruption of the Guardian Council. The change of the ruling elite in Iran is an almost impossible process. With a formally established system of elections, there are prohibitions and violations by the Guardian Council, such as ban of left candidates and cheating with counting of the votes that make the system difficult to influence and introduce a change into it.

What the sanctions are currently bringing for Iran is economic trouble, to an economy that already had difficulties before. However this has not convinced Iran to stop with the nuclear weapon development, it has only stimulated them to oppose more and show their ability to develop a nuclear weapon despite the opposition of the EU and rest of international community.

The other part of the dissertation was focused on finding the answer to the second hypothesis and its research questions. I was researching the influence that the EU sanctions have on individual member states that have a trade relation with Iran as well as on other relevant countries in international community. The gathered information have shown that the most affected will be the countries already facing severe trouble from the global economic crises. These countries are Greece, Italy and Spain. All the three countries are major importers of Iranian oil, and the dependence on oil from Iran causes great trouble considering the ban on oil imports from Iran that the EU sanctions demand. The main problem that makes it hard to find new suppliers of oil for the three countries is especially their economic situation. Their big financial trouble might make it difficult to find new

trade partners that would trust their credibility. This is especially difficult for Greece, because it had special credit arrangements with Iran, which enabled Greece to pay for oil later. Losing Iran, Greece and Italy decided to increase imports from Russia, which is already supplying most of its oil. Depending too much on one or few countries can bring further risks and threaten energy supplies. Italy is also the one country that will suffer most from eliminating Iran as a trade partner. Italy is not only highly dependent on Iranian oil, but also has a very well established trade cooperation with this country. Several companies had to terminate trade relations causing further damage to Italian economic situation. Spain has supplemented most of its crude oil coming from Libya with Iranian oil, due to the civil war in Libya. Now they are once again in a very short period of time faced with a search for a new replacement. All three countries are also under psychological pressure and insecurity that makes the bad atmosphere and stability in these countries even worse. In all three countries the oil embargo and the consequential rise of prices influenced directly the citizens. In Greece, people cannot afford to buy oil for heating, in Italy and Spain people are faced with extremely high prices gas for cars. EU imposed smart sanctions on Iran, in order not to hurt the innocent citizens in Iran. However it seems like they forgot about their own citizens that are faced with several consequences that such measures bring. The main problem that all the crude oil importing countries are facing is the increase in prices. In economically affected countries that are faced with slow economic growth, high oil prices lead to recession. Worsening the situation in countries like Greece, Spain and Italy further endangers the stability of the whole EU and its financial stability. As the imports from Iran for the whole EU represent only 0,9 % of total share of imports, and the exports to Iran only 0,7% of the total share of exports, it may seem that it is not so harmful to stop trade relations with this country. However the dependence of individual EU countries on import and export trade with Iran shows a different perspective on such a decision.

The second half are the EU countries that do not so much rely on oil imports from Iran, but have a significant and important trade relations with this country, that will be affected by the sanctions. These countries are Germany, UK, France and as mentioned also Italy. Although these countries, with the exception of Italy, are the strongest countries in EU, losing a market such as Iran is certainly not in favor of their economies. The main problem



that all the companies from these countries doing business with Iran are aware of, is that leaving Iranian market means that the trade connections they have established there will be lost forever. Chinese, Malaysian and South Korean companies would very fast replace the European companies in this strategically important country. Therefore even if sanctions will be lifted all the opportunities will already be taken.

Other relevant countries, the ones cooperating with EU or Iran, will also feel the influence of sanctions, some positive and most negative. Among the countries that will benefit from sanctions we can certainly find other oil producers, especially Saudi Arabia and Russia. Most EU and also other countries have turned to Saudi Arabia and Russia to substitute the lost Iranian oil. This will have a positive impact on the income for these two countries. This will also potentially bring closer cooperation among oil importing countries and other oil producers. Asian countries will benefit also from the new space on the market after the EU countries stop their business in Iran. They will be given new opportunities to take a place in the Iranian market. The countries that continue to do business with Iran, such as China and India, can negotiate lower prices of oil, considering Iran's economic isolation.

The relevant countries cooperating with EU will have to face some similar problems as EU members. They will have to find new oil suppliers and the trade with Iran will be more difficult. The loss of oil production from Iran will cause higher oil prices for the whole world. Turkey is faced with an awkward position, somewhere in between EU and Iran and is trying to benefit from cooperating with both sides in different ways. Certain other insecurities may occur. As EU imposes stricter sanctions, Iran threatens to close the Strait of Hormuz, which is the main road for all the oil supply and other trade for Asia, EU and the US. Since many countries turn to Saudi Arabia for oil supply, Saudi Arabia is under a lot of pressure as it has to increase its oil production in order to ensure the supply. If something goes wrong and Saudi Arabia would not be able to produce the amounts of oil needed, a lot of countries depending on it would be in trouble. Another consequence of EU sanctions on Iran is also closer ties among countries that oppose the West. Iran has been working in close cooperation with Venezuela, China, Russia and India, all very strong countries and all against the Western sanctions on Iran. They have also been supplying Iran

with material for its nuclear program. Such alliances can certainly bring worries to the international community.

According to this information we can conclude an answer to the second hypothesis and its research questions. The consequences that the EU sanctions bring to certain individual members, especially to the weakest ones, are certainly not in their benefit. They have brought many difficulties for economies of EU countries, mostly also because the strongest sanctions were imposed after 2010, when the EU was already deeply in financial crises. There were several years of diplomatic negotiations that brought no conclusions and only showed that Iran is most of the time playing with the West by giving them agreements and promises that were very soon breached. Iran saw that even though they do not cooperate there are no drastic consequences. If the economic sanctions would be imposed sooner, perhaps before the big financial crises, they would be less harmful for EU, because EU members would easier adapt to the new situation and deal with higher oil prices. The EU officials are taking strict measures in times when they should be helping member economies and not further limiting them. There was too much time left for diplomatic measures before the economic sanctions were imposed.

The imposition of EU sanctions seems to be doing more damage to its own members as it does to Iran. Basing on my research I can partly accept and partly reject my hypothesis: *EU economic sanctions on Iran bring additional difficulties and insecurities for EU members as well as for other countries in the international community, because they were set up in the wrong time period.* The research enables me to accept the statement that the sanctions on Iran bring additional difficulties and insecurities for EU members, because they were set up in a time when financial crisis in EU is at its peak, especially in the countries that are most dependent on Iranian oil. However they do not influence in such a way on all of the other countries in the international community. Certainly they will influence the countries siding with the EU that will have to find new trade partners and face higher oil prices. But the oil producing countries will certainly benefit. For the countries siding with Iran, sanctions will bring a strategic cooperation and for countries that continue to trade with Iran, sanctions will bring new place for them on the Iranian market. Therefore I can reject

that the EU sanctions will bring additional difficulties and insecurities for all other countries in international community, but only to some of them.

If we connect the conclusions that the research of the two hypotheses gives us, we can see that the sanctions bring few possibilities for success, mostly because of Iran`s regime and its interests as well the fact that it is impossible to impose such sanctions in times of global economic crises and expect not to damage EU members. In order to change the situation, Iran would have to be persuaded to care more about its economic situation than it does over its military security. This would solve both problems, stop Iran`s development of a nuclear weapon as well as terminate the sanctions and reestablish the trade relations with Iran which would give EU members more economic stability. Perhaps question that can lead to further research is whether Iranian regime can be changed without a military intervention? The new presidential elections are coming in June 2013, and Ahmadinejad cannot run for president anymore, because he already served two terms. Can the left find a strong candidate and manages to stop the corrupt apparatus of the Guardian Council that violates the right of a popular vote? Although the left is more in favor of cooperation with the West, would they really agree on a non-nuclear Iran? Perhaps even an extremist country as Iran realizes that using a nuclear weapon would have a devastating influence also on its own country, and if everyone would stop putting such importance on the arms race, even Iran would lose such a strong interest in possessing a nuclear weapon.

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